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IMPROVING CREDIT CARD CONSUMER PROTECTION: RECENT INDUSTRY AND REGULATORY INITIATIVES

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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IMPROVING CREDIT CARD CONSUMER PROTECTION: RECENT INDUSTRY AND REGULATORY INITIATIVES

Thursday, June 7, 2007

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Carolyn Maloney [chairwoman of the subcommittee] presiding.

Present: Representatives Maloney, Watt, Ackerman, Moore, Waters, Carson, Hinojosa, McCarthy, Baca, Green, Clay, Scott, Cleaver, Bean, Hodes, Ellison, Perlmutter; Gillmor, Price, Castle, Biggert, Capito, Feeney, Hensarling, and Davis of Kentucky.

Ex officio: Representative Bachus.

Chairwoman MALONEY. Welcome. The hearing will come to order. This hearing, entitled, "Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives," is the second hearing in a series that this subcommittee is holding on credit card practices.

There is no question that credit cards are an essential part of American lives. And in our increasingly electronic banking system, credit cards have replaced cash and checks for daily shopping, travel expenditures, business needs, and even paying big bills, such as college tuition.

The average American family has five credit cards. The availability of credit has proven good for our economy. Consumers spent over $1.8 trillion in 2005, using credit cards. In our society, a person without a credit card cannot rent a car, buy plane tickets at the Internet discount rate, get an advance movie ticket online, make hotel reservation, or engage in other transactions that many of us take for granted.

In many cases, the ability to pay with a credit card enables a consumer to make a purchase that they would not otherwise have been able to make at that time, or to pay an emergency bill that they were not prepared for.

As a New Yorker, I know that the credit card industry is a strong engine, not only of our national economy, but of local economies, by providing jobs and getting small businesses access to credit.

On the other hand, the use of credit cards has contributed to the increase of consumer debt to record levels. Among households that carry a balance, the average household carries over $13,000. That number is expected to rise dramatically, as consumers confront the fact that in the falling housing market, they can no longer refinance their home to pay off their credit cards or other debt.

I am concerned that we will see a perfect storm in consumer credit as these pressures converge on Americans and that the ripple effect will be felt throughout our entire economy.

Even though credit cards are indispensable to most working Americans, credit card complaints far outnumber all other complaints about banks filed with Federal regulators in recent years. In the wake of our first credit card hearing last month, this subcommittee has received a flood of correspondence from individuals with credit card complaints.

The complaints we received center on what consumers see as: arbitrary and unfairly high interest rates and penalty fees; confusing practices that constantly change in the issuer's favor; and impossible barriers to getting help to sort through a problem, even when the issuer has caused the problem.

Many people, myself included, believe that improved disclosure would help consumers avoid these pitfalls. For this reason, we set this hearing shortly after the Federal Reserve released its new Reg Z for public comment. As the first revision of Reg Z in over 25 years, it is long overdue, and much awaited.

I think it represents a considerable improvement over the present situation, in which a long outdated rule struggles to keep up with an electronic financial universe it was not designed for.

I must say, a very moving part of a hearing that we had was when the Federal Reserve chairman testified that he and his wife could not understand their credit card statement, and spent hours reading it. So this reform is long overdue.

Among the major improvements in the proposal are: a 45-day notice period for increases in interest rates; display of the Schumer Box, not only at solicitation, but at account opening; and as changes in terms prohibiting the use of the term "fixed rate" for rates that are not fixed, to name a few.

I personally like the new section that shows consumers all of the interest and all of the fees accrued for the month, and gives consumers a running total for the year-to-date. I welcome these improvements, and look forward to hearing the analysis and comments of our witnesses, starting with Fed Governor Mishkin, on this very big and important new development.

But I am not sure that even the best disclosure will be enough to resolve some of the issues that we are confronting. In our previous hearing, we explored some of the abusive practices that have attracted the most criticism: universal default; double-cycle billing; trailing interest; retroactive rate increases; and limitless over-limit fees, among others.

Some of these, such as double-cycle billing, are just too complex for disclosure, to make it fair. And if you doubt that, ask one of your issuer witnesses to explain it to you, using the numbers. It is very complicated.

More systematically, I doubt that disclosure can be enough to protect consumers when the issuer can change any of the terms of the contract at any time, and in any way. That is the case for a surprisingly large number of cards, in which consumers are completely at the mercy of issuers. Many issuers can and do change the interest rate, the penalties, overlimit fees, how rates are calculated, the payment date, and many other features.

Under the new rule, they will have to tell consumers about most of these changes in advance. But that really does not help even the most savvy customer, unless they move to a card with safe and stable terms.

Consumer advocates argue that some common practices, like any-time and any-reason increases in rate, are just unsafe and unfair. At our last hearing, industry participants pointed out that several of the large issuers have recently taken steps to eliminate some of these abuses from their own products. I am happy to say that, on our second panel, we have several issuers who have announced such steps, and will explain what they have done to develop best practices, and to get rid of bad ones.

Several large issuers have announced that they no longer use universal default. Others have announced reform of payment allocation, so that payments are applied to higher-rate accounts first. Some have said that they will abandon any-time, any-reason repricing.

As a supporter of market-based solutions where possible, I welcome these steps. Perhaps the spotlight of congressional attention has helped to produce these commendable reforms. Yet I worry that as competitive pressures grow, issuers will go back to the most profitable modes of doing business, or issuers who adopt the best practices will simply lose business to those who have not.

To discuss these issues and others, I am planning a credit card summit. I am delighted to say that the issuers testifying today—Citibank, Bank of America, Capital One, as well as J.P. Morgan Chase, and many consumer groups—have all agreed to participate.

Among the results I want to achieve from this meeting is a way to use private forces to encourage best practices. For example, what if industry, working with consumer advocates, developed a gold standard for credit cards, and certified that certain of their products met this standard?

Cards with this—the gold standard—might have easy-to-understand terms, a hotline to resolve complaints, no fees for paying online, no use of universal default, or whatever feature the group determines represents best practices. Regulators could enforce this pledge that the issuers have made.

Right now, the Federal Reserve is the only regulator with power to issue regulations banning unfair and deceptive practices under the Truth in Lending Act. It has not done much in that area. If other regulators had similar powers, perhaps we would see more regulatory monitoring of bad practices.

Even more basically, I would like to encourage the regulators to enforce the laws that already exist. For example, the regulations governing processing of payment are disregarded by issuers who process payments in a way that results in many payments being late, even though they were mailed a week ahead of time. We have

regulations to deal with this, but they are not adequately enforced, as the many letters complaining about unfair payment date practices attest to.

The Federal banking agencies have done a great deal of work effectively on safety and soundness, but they have not put the same type of attention and focus on consumer protections, and we need to improve those efforts. This is the first congressional hearing on these new proposed disclosure regulations, which aim to give credit card customers clear and accurate information, and eliminate the "gotcha" moment, when people are hit with a charge they did not expect, and do not understand.

More remains to be done, but this proposal is a long-awaited and very welcome first step. Thank you. I reserve the balance of my time, and call on Mr. Gillmor.

Mr. GILLMOR. Thank you, Madam Chairwoman. If I might, I would like Ranking Member Bachus to go first on our side, and I will go second.

Mr. BACHUS. Thank you. First of all, Madam Chairwoman, I want to thank you for having the hearing, and I would also like to associate myself with your remarks.

As the ranking member of the Financial Services Committee, many other members refer their constituents to me, or they will come to me, and they will describe a credit card practice that has occurred to one of their constituents, or sometimes a family member.

And not only that, but recently—probably in the last 2 years—more and more, I have constituents who come to me, like a young man whose wife had a premature baby. He was at the hospital for 2 months, which is a hardship case, but that doesn't excuse him from honoring his obligations, and he was paying his credit card on time.

He realized it was the last day to pay his mortgage payment, so he called his mortgage company up, and they said, "Well, you can use your credit card," so he said, "Great." He used his credit card. When his credit card bill came in, he noticed that not 8.5 percent interest was charged on that, but 24.9 percent interest on the mortgage payment.

So, he said, "Oh, my gosh," you know, so he called his credit card company, and he said, "I want to pay that off today, I am going to send you a check," so they said, "Okay." He sent that check in, plus his minimum payment for the month, and they applied it to his lowest balance.

Now, here is a young man who would have never come into my office; he probably didn't have time. He saw me in a restaurant, and he came up to me and he basically said, "Congressman, I don't think that's right." And, quite frankly, I don't, either.

Now, he explained to me that he called them back and said, "Where was I told that if I use my credit card, you know, to pay my mortgage payment, where was I told this?" They sent him something. And he said, "I have it at home. I would like to send it to you."

He sent it to me. I read it. It said, "If you make a cash payment," but he wrote on his note that he paid his tuition using a credit card some 6 months before, and what was the difference? I mean, if that

wasn't a cash payment, why was a mortgage payment? He said they explained, "Well, you know, you can either pay with a credit card, or you can write a check. And when you do something like writing a check with the credit card, that's a cash payment." He said, "I don't understand that."

Another example ia a businessman who came to me. I know him. He is worth millions of dollars. He owes nobody anything. He has perfect credit. He has two credit cards, and he uses them for convenience. And here is a guy who has 200 employees, and he has time to be outraged. He has time to get a lawyer. So what he does, around Christmas, he has two credit cards, one $15,000, one $30,000, and he goes to Europe and spends $20,000. He doesn't go over his limit; he is very careful not to do that.

But in March, he suddenly looked at his credit card, and it had gone from 8.5 percent to 20-something percent. What in the world? So, he called his bank and his bank said, "Well, we don't do that, we have referred that to another company. We referred that to another—our bank no longer does this, we farmed it out."

He has a lot of money with this bank, does business with them. They say, "You need to call these people." He calls them and he says, "What in the world are you doing? I have perfect credit. What is this about?" "Well, you either did one of these six or seven things." So, he doesn't know what he has done.

They tell him he has to write somebody else, so he writes a letter. He gets a form, which he brings in and shows me. It is two pages: "Thank you for your inquiry as to why your credit rate went up. Here are the various reasons it could have gone up." He then gets his lawyer to write and say, "Could you please tell him, in this case, why it went up?" He got another form-generated answer.

But he has looked at all those reasons, and he thinks what happens is he had two credit cards. And one of the things that it actually said in there is, "If you have our credit card, and there are other credit cards you have, and you approach your credit limit, we can up your"—and that's the only thing that could have possibly happened, because it was around Christmas.

By the way, you know he never saw the notice. But do you know when they mailed the notice, which was a form-generated thing, which said, "Important document enclosed," like we all get every day? They mailed it on December 19th. And here is a sophisticated guy who has hundreds of employees, he has lawyers at his disposal, and he still can't find out what happened to him.

Now, of course, what did he do? He immediately paid off that credit card. He immediately wrote a check and sent it in. And Americans every day are getting outraged by this. They get another credit card. And yes, you can do that. But that still doesn't make all of this right.

I am very happy that when I met with Citigroup a few weeks ago, and I talked about universal default, they said, "We don't do that." Capital One has told me, "We don't do that any more." I am very glad they're responding to that. If they don't start responding to this thing about where consumers can pay on their highest interest rate, I do believe that this Congress will take a run at it.

I can't speak for all the members of the minority, but I can tell you that I have a file, and there are 28 Republicans who have writ-

ten me letters complaining about stuff, and saying, "You need to do something about this."

I have talked with the Federal Reserve, and they have limited duties, as you know. They have to respond to truth in limit and disclosures. And they say certain abusive practices, even if we think they're abusive, even if the GAO thinks they're abusive, even if we have 40,000 letters from people saying they don't think this is right, we really can't do anything about that. If anything is to be done, the Congress will have to do it. And they have actually said, "That's your watch, not ours."

I am interested in hearing from all of you. I am going to read your testimony. But I will tell you that, as the chairwoman said, 90 percent—you know, subprime lending, it's a problem, and people have lost their housing. But the number of people—and I have had people in my district lose their houses—but the outrage over just a few of these practices is just something.

The day it came out in the Birmingham News, I'd been appointed ranking member—and, regrettably, in that article it said that we did credit cards—I received 12 calls, 12 calls from people who said, "I want to come in and talk to you." That's in my district. Thank you for being here.

Chairwoman MALONEY. Thank you for your statement. Mr. Ackerman for 3 minutes; he has been a very strong advocate for change in this area.

Mr. ACKERMAN. I thank the chairwoman and the ranking member, and I want to associate myself with their statements. And thank you for the 3 minutes, and I hope you don't cut me off as I approach my 3 minutes.

[Laughter]

Mr. ACKERMAN. Be careful driving today, because as you approach the speed limit, maybe you could get a ticket.

Consumer credit card issuers, consumers, regulators, certainly members of this subcommittee, should all agree that the Federal Reserve Board's recent proposed rule changes to Regulation Z are long overdue.

Presenting potential credit card customers with easy-to-read, clear, and understandable disclosure statements that plainly summarize the terms, fees, and interest rates that come with a particular card is more than just a good idea. It's a good idea that should have been implemented a long time ago, and without the necessity for Federal involvement.

Such a requirement is not only ridiculously obvious, it is profitable. Informed consumers are not only happier people, they are better long-term customers.

Over the past 15 years, credit card issuers have increased the number of solicitations sent to consumers by more than 500 percent. Consumer protection has, sadly, not kept pace.

When finalized, the proposed changes to Regulation Z will allow millions of Americans to put away their magnifying glasses, legal dictionaries, and crystal balls when combing through the piles of credit card offers they receive every month. Unfortunately, however, they will still need their life jackets and umbrellas to keep them from getting soaked by some of the more sinister credit industry practices that have, sadly, become commonplace.

Perhaps the most infamous of these practices is universal default, a practice that substantially increases a consumer's annual interest rate because, just once, they forgot or failed to pay any other creditor on time.

There is also double-cycle billing, a system under which a card issuer assesses interest retroactively on debts that may be partially or almost completely paid off.

Then, of course, there are so-called pay-to-pay fees, under which the credit card consumer is charged simply for the opportunity to pay their bill online or by phone, bills that are deliberately sent late in the month.

Each of these practices are legal; none of them are fair. None of them are necessary. There is no question that the consumer credit industry is critical to our economy, and that our credit cards have been a boon to millions of American households. But the protection of consumers is not the credit card industry's job, it is ours. And it is past time for consumer interests to get a boost.

As a small contribution to this rebalancing of interest, I have already introduced legislation that addresses the pay-to-pay problem. I am looking forward to hearing from our witnesses about industry plans to correct some of these and other egregious practices. It is my hope that they will be able to tell us about their plans to pursue more responsible, consumer-friendly business practices, and how quickly they plan on doing so.

But I am not quite ready to give up my crystal ball. Thank you very much, Madam Chairwoman.

Chairwoman MALONEY. Thank you. Ranking Member Gillmor, for 5 minutes.

Mr. GILLMOR. Thank you, Madam Chairwoman, for calling this hearing today. And I also appreciate your comments on the issues in your opening remarks.

Americans today have access to the best financial services in the world, and a critical part of those services is the credit card. The credit card industry has expanded rapidly over the past decade. We now have close to 700 million cards in use, and if my mailman is right, there are a few thousand more.

The popularity of the credit card as a payment option has allowed for an evolution of credit card policies and fees. There are literally thousands of products offered by credit card issuers, all with different fees, rates, and features.

With market competition and innovation, credit card issuers seem to be willing to adjust their products when consumers demand that a change is necessary.

Recently, some of the largest credit card companies voluntarily modified some of their risk-based pricing policies, such as double-cycle billing. And I would expect this trend to continue, as a consumer with a bad deal can now shop around with more ease.

Due to the nature of credit cards, fees are a major component of how an issuer is able to recoup the dangers of extended credit with no collateral. It is fair for banks to constantly evaluate how best to charge for the risks associated with particular segments of borrowers. What is unacceptable is for issuers to hide fees, policies, or practices from their customers.

Disclosure is a major part of the answer, and that's why earlier this year Ranking Member Bachus and I sent a letter to Fed Chairman Bernanke requesting a prompt review of Regulation Z. I am pleased with the work of the Federal Reserve, in putting out this proposal, by completing overhauling the notices presented to perspective and active credit card customers. Consumers should be in a better position to evaluate their terms and to shop around.

In particular, I was pleased to see the Federal Reserve attempt to simplify the disclosure of fees and interest. By presenting the customer with a box detailing their interest rate charges and fees for the year, the periodic statement will become a wake-up call for some Americans who have experienced the problems of reckless spending.

From this exercise, and extensive consumer testing, the Fed hopefully has a clear picture of what the average credit card customer understands about their account, and what they do not. I look forward to closely examining the comments offered by the witnesses today, and to further revisions to this proposal. I yield back the balance of my time.

Chairwoman MALONEY. Thank you. Congressman Scott, for 1 minute.

Mr. SCOTT. Thank you very much, Madam Chairwoman. Again, this is certainly a very, very timely hearing. It is a very, very important hearing for us, and credit cards have a great purpose, but we have some tremendous problems.

And more needs to be done, such as: eliminating unfair retroactive penalty rate hikes; requiring card issuers to apply consumer payments to a portion of their debt with the highest interest rates; and prohibiting over-limit fees from being repeated for a single over-the-limit purchase.

We have to do more focusing on the fundamental problems in credit card marketing that allow these issuers to change the rules at any time, and impose retroactive interest rate increases.

Now, I understand that we cannot and we will not, put all the blame on the card issuers, as some people just have bad credit. We know that. They make mistakes. However, it seems to me that many of these banks are simply not straightforward about their varying and confusing charges and rates. The so-called practice of universal default is of major, major concern.

And, in conclusion, Madam Chairwoman, I would just like to say that credit cards do serve a purpose. And as we said, we are not here to cast blame upon them. We need them. We just need them to be right, and to treat the American people right, because it is a fact that significant and aggressive changes have been made by the industry over the past decade, at the expense of their customers. I believe it is of utmost importance that these issues are addressed. Thank you, Madam Chairwoman.

Chairwoman MALONEY. Congressman Castle, for 5 minutes.

Mr. CASTLE. Thank you, Madam Chairwoman. I will submit a statement for the record, and I will try to do this relatively briefly.

I am one who believes that credit cards are indispensable to our consumer economy in America today. I doubt if there is anybody in this room who does not use credit cards. My father is probably the last person not to use credit cards, if I had to guess. They are just

a fact of life. Probably most people in this room are carrying more than one credit card, if I had to guess.

I believe that it is absolutely vital that we have transparency here, that people understand what they are dealing with. A lot of the confusion—I am from Delaware, where we have a lot of credit cards—but a lot of the confusion that comes into play happens because people simply don't understand what the ground rules are.

They understand that they are going to have to pay interest. They understand that they are going to have to pay late charges. They understand, perhaps, fees for a card, or whatever it may be, and there are certain practices which I think you all are addressing, and some of the bigger credit card issuers are addressing themselves, but there are a lot of little things that I think fall into the category of non-transparency.

I think it is very hard to read some of the so-called disclosures, or even the bills and the forms, and understand exactly what it is you are supposed to do. I can tell you in my own case, I never know when I am supposed to pay my credit card payment by; it is usually very hard to determine that.

So, I think exposing that, and making it as public as we can is vitally important. Whether or not we should do that by legislation or regulation, or working with the credit card issuers is something I am not as sure about, but I am doggone sure that needs to happen.

I think there are practices which are questionable. Some of the fees which are charged, the universal charges, some of the other things that we have seen, which are very questionable, should be looked at carefully, as far as credit cards are concerned.

I also think that the consumers themselves, all of us who are consumers, need to be paying attention to this, as well. I mean, it's sort of burying your head in the sand to say that, "The credit card companies sent me 20 credit cards. They are at fault. I accepted 10 of them, and I spent this amount of money, and now I am in serious debt." It's like saying a bartender kept filling your glass, when you asked him to fill your glass. There has to be some understanding by the consumers of what their responsibilities are, as well.

But I just sense this lack of connection between what is happening in the marketplace, and what people understand of what their responsibilities are. And I think that we should, as a group, work together to attempt to make all of that as clear as possible, be it the box or some other methodology, to make absolutely sure that there is a clear understanding of what we are dealing with.

With that, I think we would resolve a lot of the problems, and that way, individuals who are saying, "We didn't understand what was happening," will no longer be able to use that excuse, and maybe they can't pay their credit cards for a variety of reasons, but the excuse won't be they didn't comprehend or understand what the circumstances are.

I would hope that all of you in the various agencies would work very hard towards this end. We started to see some of that, and I think that's positive. And I think our committee is going to be vitally concerned about it.

I would like to associate myself with practically all the segments I heard here today by each of the members. I believe that we have identified what a number of the problems are, and what we have to do for solutions. And, hopefully, we can do it in a way that will benefit everybody, and not be too Draconian. With that, I yield back.

Chairwoman MALONEY. Congressman Cleaver, for 3 minutes; he has offered an important bill on this subject.

Mr. CLEAVER. Thank you, Madam Chairwoman. I would also like to express appreciation to Congressman Ackerman and Congressman Ellison, who, along with you and the ranking member, are extremely interested in, and committed to doing something about this issue.

Fortuitously, today's Washington Post carries a very, very sad story about a woman by the name of Erica Bermudo, who left college last year with $5,000 in credit card debt. There is no way in the world she should have ever gotten a credit card in the first place.

And Congressman Udall and I drafted legislation based on what we had seen, and the complaints received like those from Ranking Member Bachus. And they ought to: require advance notice of interest rate increases, unless they reflect the end of an introductory rate for new accounts, or indexation to rate; require letting card holders avoid paying a higher rate by canceling the card in time; require card holders paying by mail to be told the date on which a mail payment must be postmarked, in order to avoid fees charged or increased interest rates; require that if a card issuer accepts payments made in person, a payment made at least one day before the due date would mean no late payment penalties; bar changing fees or other penalties because a credit card holder pays more than the monthly premium, or pays in full an existing account balance; bars imposing fees for charges that put a card over the credit limit if the issuer has authorized that charge, either in advance or at the time of the purchase. And it also requires that if a college student without employment is issued a card, that the parent or someone with a job assume responsibility for that card.

The last time we held a hearing on this subject, as I began to talk about this, one of my colleagues mentioned that the representative of the credit card industry was shaking his head, which has inspired me, because I know, then, that we must be going in the right direction.

We are representatives of the people of this country, and we get complaints over and over and over again with what is going on in the credit card industry. This means that change is needed. And change does not roll in on the wheels of inevitability. This means that we must make the changes, and I am prepared to do so.

I yield back the balance of my time. Thank you, Madam Chairwoman.

Chairwoman MALONEY. Congressman Hodes, for 1 minute.

Mr. HODES. Thank you, Madam Chairwoman. I want to thank you for holding this important hearing, and to associate myself with the remarks of my colleagues, especially those of Mr. Cleaver.

I am very concerned about credit card practices in this country, and the impact that these practices are having on my constituents in New Hampshire.

Frankly, we are a nation in debt, and a nation of individual debtors. Credit cards have given consumers unprecedented buying power, and help to propel our economy. But easy credit and confusing credit card company practices have come with a very high price for many consumers.

Experian Consumer Direct, a division of one of the major credit reporting agencies, issued a study in February of this year stating that the average person in this country has four credit cards. The report also found that 14 percent of consumers have 10 or more credit cards. New Hampshire is one of two States with the highest percentage of residents with that many cards.

So while, clearly, credit cards are a valuable fixture of our economy, the high fees that the consumers face, and the way that disclosures and practices work, are of deep concern. I appreciate the proposal on Regulation Z as a first step. It's a good first step. And as you can hear, the tone of Members of Congress is very moderate.

I have been subject to enough craziness with credit cards on my own, as the average everyday consumer, to come to Congress without any patience. I have no patience for the credit card industry, and I intend to join with my colleagues to protect my constituents, and the consumers of this country.

Thank you very much, Madam Chairwoman. I yield back.

Chairwoman MALONEY. Congresswoman Biggert, for 1 minute.

Mrs. BIGGERT. Thank you very much, Madam Chairwoman. I wasn't going to make an opening statement, but I think there is one piece of information that we are missing here, or has not been talked about, and that is financial literacy.

And Congressman Hinojosa and I have been working on this. We have a financial literacy caucus here, in the House, and I think that what we found is that kids, middle school kids, didn't even know the difference between a check, credit card, and cash. And I think that we not only, you know, do—the credit card companies—and I congratulate all of those who have really worked on financial literacy. But to take up—the public agencies have been working on financial literacy, and a lot of the private industry. And I think that we are making some gains in the education.

But if we start with the premise that the kids don't know that, and then they get to college, where they are given all of these credit cards without any education, I think it is part of our responsibility, as a public entity, and the private entities, to really increase the education, and start probably in the schools.

And I have been working with schools that have so many programs that are working with the private. So I think that we are moving ahead, and it's not all doom and gloom, that—but it's amazing that—the lack of financial literacy that people in this day and age don't have, and we need to improve our education on that. I yield back.

Chairwoman MALONEY. Congressman Ellison, for 1 minute.

Mr. ELLISON. Madam Chairwoman, thank you for allowing me to weigh in at this point. I do have a statement I would like to submit for the record, but just briefly, I would like to say that this con-

versation takes place within the context of flat or declining real wages for working people, rising health care costs, stricter bankruptcy rules, and a generally difficult time for the working and middle-class people of the United States.

So, where do credit cards fit into this profile? Some of the practices just make things worse. And I would just like to urge the industry to remember that we cannot kill the goose that laid the golden egg. When the American working person, who is also the American consumer, begins to feel the pinch too severely, it's not long before the corporate structure will begin to feel that same pain. Just as we have seen foreclosures in the subprime market, we have now seen the difficulties for people on Wall Street.

So, I commend those parts of the industry that have said that, "We are not going to engage in universal default, double-cycle billing, pay-to-pay," but I agree that when the pressure of competition comes down, we need to keep good lenders good. I am in favor of banning these practices, because I want our financial industry to maintain a good reputation among American consumers, and I think it has suffered a lot under some of these questionable, unethical practices.

I just want to say, as I wrap up my remarks, that there is something known as a dram shop action. That means if you're sitting in a bar, and they keep on pouring, and you keep on asking, that, yes, the consumer may have responsibility, but the bar will, too. But the bar will, too.

So, I think it's important for us all to bear in mind, that while financial literacy is important, and while disclosure is important, responsibility of the industry cannot be misdirected or sent away. Thank you.

Chairwoman MALONEY. And, finally, Congressman Hinojosa, for 1 minute.

Mr. HINOJOSA. Thank you, Madam Chairwoman. I want to thank you, and express my sincere appreciation to you for holding this important hearing on credit cards today. I look forward to participating in future hearings on this issue.

I understand that credit cards are used by credit bureaus and others to help determine credit worthiness of those seeking to purchase goods and services. And so I say that it is extremely important for me to identify myself with the other members who have expressed concerns on what is happening in this industry.

However, I must stress in the 1 minute given to me by the chairwoman, to express concerns that I have with college education and savings, as it refers to credit cards. We are trying to reauthorize the Higher Education Act this year. And in all the hearings, we hear about how difficult it is on the two things that we talk about, and that is accessibility to higher education, and affordability.

Credit cards are being used to address the need for affordability to buy books, to pay for college tuition, and many things like that. Why? Because savings in this country are now negative, compared to the 3 percent we used to save 10 years ago. And credit cards are contributing to this problem of negative savings, and the negative problems in being able to afford college education.

I invite you to join our coalition of Jump Start. Judy Biggert and I have worked with financial literacy education being available to

students and parents at the 9th, 10th, 11th, and 12th grades, and in other groups, not just the high school students.

But there is a serious problem, and if we can't work together to address it, then you force Congress to then make it very difficult to use a credit card for the purposes that I have expressed my concerns. So I invite you to dialogue with us, so that we don't have to go so far beyond what is necessary to prevent use of cards as it refers to college education. With that, I yield back, Madam Chairwoman.

Chairwoman MALONEY. Thank you very much. And any other statement can be put in the record.

We are very fortunate today to have an all-star cast testifying: the Honorable Frederic Mishkin, Governor, Board of Governors of the Federal Reserve System; the Honorable John Dugan, Comptroller, Office of the Comptroller of the Currency; the Honorable Sheila Bair, Chairman, Federal Deposit Insurance Corporation; the Honorable John Reich, Director, Office of Thrift Supervision; the Honorable JoAnn Johnson, chairman, National Credit Administration; and the Honorable Richard Neiman, superintendent of the New York State Banking Department, who is representing the Conference of State Banking Supervisors.

Thank you all for coming, and we look forward to your testimony. Governor Mishkin.

STATEMENT OF THE HONORABLE FREDERIC S. MISHKIN, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MISHKIN. Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, I appreciate the opportunity to discuss the Federal Reserve Board's May 23rd proposal to make credit card disclosures more effective.

In the last 25 years, credit cards have gone from being fairly common to being nearly ubiquitous. At the same time, credit cards have become more complicated, with more features and more complex pricing. Their complexities have bred concerns about the fairness and transparency of marketing practices, and account terms.

The Federal Reserve Board believes our proposal helps to address many of these concerns. Our proposal seeks to ensure that consumers receive key information about the cost of credit cards in ways they can understand, in formats they can use, and at times when it is most helpful.

It is our belief that more effective disclosure will make consumers less likely to fall into traps for the unwary, and better able to choose suitable products and to use them wisely. Better disclosures should also enhance competition among credit card issuers, and competition is usually the best cure for unfairness.

As we developed new disclosures, we considered what individual consumers themselves had to say about them by conducting extensive consumer testing. In one-on-one interviews, consumers told us what information they find useful when making credit card decisions, and what information they ignore. We learned which words and formats for presenting information promote understanding, and which do not.

These lessons are reflected in a myriad of preliminary judgements we have made about the appropriate content, format, and timing of disclosures. I want to highlight some of the improvements our proposal would make.

Advertisements of so-called fixed rates would be restricted to rates that are truly not subject to change, either for the life of the account, or for a clearly disclosed period.

The Schumer Box, currently required only with credit card solicitations and applications, would be updated to more effectively present information about rates and fees.

Summary tables, similar to the Schumer Box, would accompany the lengthy, complex credit agreements that consumers receive at account opening, and when terms change. Penalty rates and fees would be highlighted in the Schumer Box, and in the other summary tables, and a reminder of late payment penalties would appear on every periodic statement.

A consumer would be sent notice 45 days before a penalty rate was imposed, or the rate was increased for other reasons.

Fees would be highlighted on the periodic statement. Fees would be grouped together in a prominent location. Fees would also be totaled for the billing cycle, and for the year-to-date.

Another way of disclosing the cost of credit, the effective APR, is the subject of two alternative proposals: One, to try to make it more meaningful; and two, to eliminate it if a meaningful disclosure is not reasonably attainable.

A warning about the higher cost of making only the minimum payment would appear on the periodic statement, as the Bankruptcy Act requires. The proposal seeks to fulfill the spirit, not just the letter, of the Act. It would provide creditors incentives to base their estimate of the time to repay the balance on actual account terms, and to place that estimate directly on the periodic statement, rather than ask the consumer to call a toll-free telephone number.

We expect that these and other aspects of our proposal would help consumers and improve competition, without imposing unwarranted burdens on credit card issuers. We have detailed the reasons for this expectation at great length, so that the public can evaluate our proposal, and tell us how we can do better.

Madam Chairwoman, I look forward to our continuing efforts to ensure that consumers with credit are well informed, and consumer credit markets are well functioning. I am happy to address any questions you and the members of the subcommittee might have. Thank you.

[The prepared statement of Governor Mishkin can be found on page 249 of the appendix.]

THE HONORABLE JOHN C. DUGAN, COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. DUGAN. Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, I appreciate this opportunity to discuss the effectiveness of credit card disclosures and related issues.

The credit card is, in many ways, a remarkable success, evolving from a novelty to an essential payment device for roughly three-fourths of American households. Credit card terms, marketing, and account management practices have also been evolving, in response to intense competition for customers and revenue.

This competition has led to the virtual elimination of annual fees, lower interest rates for most consumers, and increased credit availability for more Americans. But competition has also led to more complex and aggressive pricing structures, as issuers seek to more effectively target customers, generate additional revenue, and manage their risks.

Indeed, from a lender's perspective, credit card loans are perhaps the riskiest form of consumer credit. Unlike a home mortgage, a credit card loan is unsecured and open-ended. That means the borrower can increase the loan amount at any time, up to a specified limit, and the borrower can keep large balances outstanding for long periods.

As a result, credit card accounts require substantial ongoing risk management, because a borrower's creditworthiness can deteriorate over time. One way that card issuers mitigate this risk is through changes in pricing, whether through increased interest rates or fees.

Such risk-based pricing can be an important risk management tool. But the practice has also generated sharp criticism and numerous complaints, especially from consumers who were unaware that the cost of their credit could increase.

This last point implicates the key focus of this hearing, the effectiveness of disclosures. As the GAO noted last year in its comprehensive report, disclosures are the primary means under Federal law for protecting consumers against inaccurate and unfair credit card practices.

Unfortunately, disclosures plainly have not kept pace with the changes and complexities in credit card practices. Neither has disclosure regulation. In particular, such practices as universal default and double-cycle billing have been especially difficult for consumers to understand, given current disclosure rules.

The OCC does not have the legal authority to issue regulations under the primary consumer protection statutes that govern credit card lending. Nevertheless, we do supervise many, but not all, of the largest credit card issuers. As described in detail in my written testimony, the OCC has a comprehensive risk-based program for oversight of credit card lending by national banks, using four primary tools: examination; complaint analysis; supervisory guidance; and enforcement.

But there are limits to what the OCC can accomplish alone to reform disclosure practices, and that is why the Federal Reserve undertaking to revise its disclosure rules is so important. Changes to Regulation Z would set new standards that apply to all participants in the credit card industry.

And improved effective disclosure of credit card terms can have three fundamental benefits for consumers: first, informed consumer choice; second, enhanced issuer competition to provide consumers the terms they want; and, third, greater transparency that will hold the most aggressive credit card practices up to the glare of

public scrutiny and criticism, making issuers think long and hard about the cost of such practices before implementing them.

Our preliminary reaction to the Board's proposal is very positive, as it incorporates many of the approaches to effective consumer disclosures that we previously recommended. Nevertheless, we do expect to provide additional suggestions during the comment period.

A lingering question, of course, is this: Can improved disclosure be sufficient to address the fundamental issues raised by current credit card practices? We certainly hope so, and we believe changes to Reg Z show real promise for addressing a number of these issues.

Moreover—and this, frankly, is partly due to public criticism raised by members of this subcommittee and others—most national bank issuers have already moved away from such practices as universal default and double-cycle billing.

In addition, there are potential costs associated with going beyond disclosure. For example, proposals to restrict risk-based pricing could have unintended consequences regarding banks' ability to manage risks, or on the availability and affordability of credit cards, more generally.

As Congress continues to weigh these issues, the OCC stands ready to provide additional information that the subcommittee may need, based on our supervision of national banks. Thank you very much.

[The prepared statement of Comptroller Dugan can be found on page 131 of the appendix.]

STATEMENT OF THE HONORABLE SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Chairwoman Maloney, Congressmen Castle and Bachus, and members of the subcommittee, I appreciate the opportunity to testify on credit card practices.

Today, more American households are using credit cards than ever before. Three in four households have some type of credit card. Nearly half carry a month-to-month balance, despite the high APRs. And the size of that debt burden for the typical household has increased by two-thirds since 1989.

Recent growth in credit card debt is notably significant among lower-income people and young people, a trend I find troubling. FDIC-supervised banks have about 15 percent of the total credit card debt for all banks. That amounts to $104 billion of reported credit card receivables, with most of that consolidated in the two largest FDIC-supervised credit card banks.

Bank credit card practices are examined as part of both our safety and soundness examination and our compliance examination. This coordinated approach is especially important in supervising credit card banks, where safety and soundness and consumer protection issues overlap considerably.

Last month, as you know, the Federal Reserve Board proposed amendments to Reg Z, the rule that implements the Truth in Lending Act, which governs credit card lending and other forms of credit. These new rules would make important changes to the format, timing, and content requirements for billing statements and other notices given to consumers about their credit cards. These changes

should significantly improve the quality of credit card disclosures and are a highly positive step forward.

TILA is, for the most part, a disclosure-based statute, as it applies to open-end credit. This may not be the best vehicle for prohibiting certain controversial practices, many of which were identified in the recent Government Accountability Office report. Some of these problematic practices are very complex, and difficult to explain. I am not convinced that full disclosure will completely address them.

I would also like to note that while practices in the prime market have raised many concerns, we often see more egregious practices in the subprime credit card market. These include deceptive marketing, inadequate account disclosures, and accounts that have little or no credit left after opening fees and other charges are imposed.

We use our supervisory authority to address unfair and deceptive practices by the banks and thrifts that we supervise. However, the FDIC does not have rulemaking authority under the Truth in Lending law, or the FTC Act.

The FDIC is reviewing to what extent troubling credit card practices can be adequately addressed by supervisory action, or if some of the practices can be addressed through our safety and soundness rulemaking authority. It may be that some of these practices would best be addressed through rulemaking under unfair and deceptive acts and practices.

Let me end by saying that growth and innovation in the credit card industry has had many positive effects on the economy and consumer access to credit. However, current industry practices and increasingly complex product innovations pose major challenges in maintaining a balance between bank profitability and consumer interest. Thank you very much.

[The prepared statement of Chairman Bair can be found on page 85 of the appendix.]

STATEMENT OF THE HONORABLE JOHN M. REICH, DIRECTOR, OFFICE OF THRIFT SUPERVISION

Mr. REICH. Good morning, Madam Chairwoman, Ranking Member Bachus, and members of the subcommittee. Thank you for the opportunity to address current issues with credit card lending by the thrift industry.

By statute, thrifts must maintain 70 percent of their assets in mortgages and mortgage-related assets. However, this requirement makes accommodation for certain retail lending activities of thrifts, including credit card lending. This benefits consumers by increased competition among lenders, and promotes asset diversification and balance in a thrift operation, by avoiding exposure to a narrowly-focused lending strategy.

The authority for Federal thrifts to issue credit cards is subject to OTS authority to supervise this activity. OTS authority includes the ability to examine, regulate, and limit the credit card operations of a Federal thrift to protect the institution and its customers.

In addition to monitoring the performance and capital of thrift credit card lenders, we monitor the marketing, pricing, fee, and

servicing practices of these programs. An important component of this is overseeing compliance with consumer protection laws, and institution account management and collection activities.

We are particularly mindful of reputation risks that could undermine the safety and soundness of an institution and/or the Federal thrift charter out of which an institution conducts its credit card operations.

In connection with our examination approach, we regularly conduct combined exams for safety and soundness and compliance with Federal consumer protection laws, including the Fair Lending Act, the Equal Credit Opportunity Act, and the Truth in Lending Act.

We also examine for compliance with our regulations that prohibit discrimination and misrepresentations in advertising.

We also track individual institution consumer complaints relating to various potential regulatory violations, including credit card lending programs.

I should also mention that we hope to soon finalize an agreement with the Conference of State Bank Supervisors that will be a framework for sharing consumer complaint information with the States.

Consumer complaint records play a significant role in our examinations, in assessing an institution's compliance management program, and in pursuing corrective action that may be appropriate to address programmatic weaknesses or deficiencies.

We follow up with institutions on all consumer complaints filed with the Agency. This process is subject to stringent review timeframes, and we strive to provide timely and complete responses to consumers in all matters. We encourage institutions to resolve complaints directly, but we intervene when necessary to resolve a dispute.

Fundamental to our oversight is ensuring that institutions conduct their activities in a manner consistent with sound consumer protection. If an institution's lending programs are potentially predatory, or lack adequate controls to support responsible lending, there are numerous options we can take to eliminate these risks. These include formal and informal supervisory approaches. While we often find informal actions to be sufficient and effective, we do not hesitate to use our formal enforcement authority when it is appropriate to do so.

With respect to the Fed's proposed revision to Regulation Z, the proposal provides consumers with more time, better practical disclosures, and more comparative information upon which to make important credit decisions.

I support these modifications, and encourage the Fed to consider all practical solutions to minimize potential regulatory burdens, particularly on smaller institutions under the proposal.

The OTS will continue to work with our institutions to ensure safe and sound underwriting standards, and strong consumer protections. Thank you, Madam Chairwoman, and the members of the subcommittee, for holding this hearing, and for the opportunity to present OTS's views on these issues.

[The prepared statement of Director Reich can be found on page 281 of the appendix.]

STATEMENT OF JOANN M. JOHNSON, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Ms. JOHNSON. Good morning. Thank you for giving me the opportunity to testify today regarding improving credit card consumer protections. This is a timely and important subject that merits congressional oversight, and I commend you for your interest in improving the rules available to help consumers as they face a crowded landscape of credit card options.

The Fed implements truth in lending through Reg Z, which applies to both Federal and state-chartered credit unions. NCUA is responsible for enforcement of Reg Z for Federal charters, while the FTC has responsibility for enforcement in state-chartered credit unions.

Additionally, Federal credit unions are subject to further requirements specified in the Federal Credit Union Act. Regardless of the source of regulatory authority, NCUA places a priority on ensuring that credit unions make clear and concise disclosures to members, and also work to protect consumers against inaccurate or unfair billing practices.

NCUA uses regulatory alerts, letters to credit unions, and legal opinion letters to inform credit unions of their responsibilities to consumers under Reg Z. This regime has created a solid basis for credit union compliance with the law, and has promoted a system where credit card services are provided to members in a fair and understandable manner.

Before I discuss specifics of NCUA oversight of credit unions, I would like to describe the industry's participation in credit card services. As of March of this year, just over one-half of all federally-insured credit unions offered credit cards to their members. Credit unions hold roughly 3 percent of the credit card market. Credit card loan growth in credit unions has averaged 4.2 percent over the last 5 years, and credit card balances represent 5 percent of total credit union loans.

I want to underscore the fact that Federal credit unions are subject to an 18 percent cap on loan rates imposed by NCUA regulation. This cap has been in place since 1987. NCUA's policy is to include any credit fees as finance charges for purposes of the 18 percent cap, if those fees would be defined as a finance charge under Reg Z.

The average outstanding credit card balance at year-end 2006 was just over $2,000, with an average interest rate of slightly more than 11 percent. These rates are lower than the national average for credit cards issued by other providers.

I also note a 2005 Woodstock Institute study that found pure complexities and more consumer-friendly terms offered by the 10 largest credit union issuers, versus other large issuers.

Another issue relevant to the credit card discussion is that of Federal pre-emption of State law. NCUA has narrowly exercised its authority to pre-empt State laws, pre-empting only those laws affecting rates, terms, and conditions of loans offered by Federal credit unions, and other laws affecting certain fees.

NCUA does not pre-empt State consumer disclosure laws, particularly those that emphasize plain-English descriptions that help

consumers gain a better understanding of terms, or laws pertaining to insurance, collections, contracts, or attorneys' fees.

While our general observation is that States in the areas of disclosure have taken steps in the right direction to protect consumers from harmful practices, NCUA believes having Federal requirements is beneficial for two reasons: One, it means a consistent, national practice, so that consumers in one State will get the same disclosures as those in another State; and, two, it clarifies the rules for financial institutions with locations in more than one State.

I now want to turn to oversight, and enforcement of Reg Z. Through its examination and complaint monitoring process, NCUA plays a significant role in making certain that consumers are appropriately protected.

During its safety and soundness exams, NCUA also clearly communicates to the credit union its responsibilities for complying with consumer protection rules, including Reg Z. We also communicate penalties that could result from violations. When a violation is noted, corrective actions are taken.

During the almost 8,000 exams completed in Federal credit unions in 2006, NCUA noted 305 violations of Reg Z; 17 of those violations were specific to credit cards, and were addressed through the examination process, or other NCUA methods, such as documents of resolution or examiner findings. All of these can adversely affect the credit union's CAMEL rating.

NCUA also maintains a structured consumer complaint resolution process. Our agency's Web site features a complaint center where consumers can directly contact our regional directors to register complaints or problems. Complaint logs since 2004 show few complaints about credit card practices. The 80 that specifically pertained to credit cards focused on misunderstandings of terms and payment disputes, and they were resolved by our regional staff.

The Fed is in the midst of an extensive review of Reg Z, and we are assessing these changes, and are pleased with many of the changes we see.

In closing, I would like to say that although it's not a panacea, financial education, in concert with effective regulation and responsibility, can play a key role in improving consumers—empowering consumers to make the right choices. And we look forward to working with you to make these changes. Thank you.

[The prepared statement of Ms. Johnson can be found on page 185 of the appendix.]

STATEMENT OF RICHARD H. NEIMAN, SUPERINTENDENT, NEW YORK STATE BANKING DEPARTMENT, ON BEHALF OF THE CONFERENCE OF STATE BANKING SUPERVISORS (CSBS)

Mr. NEIMAN. Good morning, Madam Chairwoman, and members of the subcommittee. I am Richard Neiman, superintendent of banks for the State of New York, testifying today on behalf of CSBS.

I am pleased to be here today to share our views on the need to improve disclosures and protections for users of bank-issued credit cards. Being here also has a special meaning to me, personally, because this is where my introduction to Federal financial institutions and legislation began.

As a congressional intern, I worked my way through college for the then-House Banking Committee under Chairman Wright Patman, and staff director, Dr. Paul Nelson. Who would have predicted that I would return to the same committee, over 30 years later, only now as superintendent to address this important issue? So, I thank you again, and I am very honored to be here.

Although CSBS has not formalized any Federal policy recommendations, the question of how to best protect credit card borrowers is a priority for State bank regulators, and one with broad-reaching implications for State authority, for pre-emption, and the balance of our dual banking system.

Today, I would like to highlight three areas that I believe need to be acknowledged and acted upon: one, the most troubling credit card practices we have identified in New York; two, the need for a Federal response to address abusive practices, and ensure that consumers receive meaningful information about credit card terms; and three, the important role States have played, and should continue to play, in protecting consumers.

Credit cards are a major source of complaints for State law enforcement authorities and regulators. In 2006 alone, the New York attorney general received 4,000 credit card complaints, second only to the number of complaints about the Internet.

According to the GAO, credit card issues are the largest source of complaints for the OCC, the Federal Reserve, and the FDIC.

In New York, we have identified a number of credit card issuer practices that can be misleading or abusive, including those relating to universal default, double-cycle billing, unilateral changes in terms, deceptive promotion, and certain excessive penalty rates, overlimit, and late fees.

However, OCC and OTS pre-emption of State laws has significantly limited a State authority to address these issues. A series of court decisions over the past 30 years has essentially eliminated a State's ability to protect consumers from abusive lending practices by lenders other than those lenders we directly charter.

We believe that the public is best served by a system that provides effective and balanced dual Federal/State regulation. The Federal Reserve Board's recently proposed changes to Regulation Z are an important step in ensuring that consumers receive meaningful disclosures of credit card terms.

However, credit card issuers should not perceive that simply by complying with required disclosures, they may continue to engage in practices that confuse and mislead consumers. Better disclosures, while important, are not a panacea.

In considering solutions to the problems in the credit card industry, Congress should look at and support the role that States have played, and we hope will continue to play, in protecting consumers: first, through enforcement actions, such as those brought by the New York attorney general against subprime credit card lenders for deceptive practices; and second, through regulatory and legislative solutions that can serve as models for Federal regulation. New York and other States have pioneered initiatives in all aspects of consumer protection that can serve as Federal models.

Third, through information gathering and monitoring compliance. On the State/Federal front, the regulatory landscape post-

Wachovia demands more, not less, interaction. One example of inter-governmental partnership is the MOU that New York, as the first State, entered into with the OCC this past November, to enhance the resolution of consumer complaints.

States are also in a position to provide valuable public information about credit card practices, and the cost of credit. The availability of credit to Americans across income lines has undeniable benefits to individuals, to households, and to the economy. Lending practices that have the effect of destroying a borrower's credit rating and financial future, however, fly in the face of our shared goal, which is to make the widest possible range of safe and sound banking services available to consumers.

We look forward to sharing our views with the Federal Reserve, as it continues in the process of amending Reg Z, and we also seek additional opportunities to work with the Federal banking agencies to share best practices on monitoring compliance and consumer protection laws.

Thank you for inviting me here today, and I would be happy to answer questions at the end. Thank you.

[The prepared statement of Mr. Neiman can be found on page 266 of the appendix.]

Chairwoman MALONEY. Thank you for all of your testimony.

I would like to ask Governor Mishkin, while this proposal is very important and a very major, long-awaited updating of credit card disclosure, other regulators and consumer advocates believe that it is not enough to crack down on abusive practices that my colleagues and I have been talking about today.

As I understand it, the Fed is the only regulator that has authority to regulate substantive credit card abuses. And I would like to ask you if that is correct. And if so, are you planning to use that power to regulate the abuses we have been talking about today?

Mr. MISHKIN. Thank you, Madam Chairwoman. We believe that the very key step, in terms of getting markets to work well, and to benefit consumers, is that they get sufficient information to make decisions that will do two things. One is they can make the right decisions, but also, that they encourage people who are providing them with the products to actually give them a product that is a good product.

And our view is that this step that we have taken, in terms of this disclosure, is actually a very important step in exactly that direction.

In terms of whether this will completely solve the problem, we don't know. And surely we will consider whether, in fact, other steps might have to be taken. But we also do have to be aware that when you write regulations, it's not easy to do, and you don't want to have unintended consequences that you will find after the fact are undesirable.

So we do feel that this is an important step, in terms of disclosures, that we think that this will have a big impact on the markets, and we are hoping that, in fact, we can get comments on this disclosure proposal, and in fact, then take it from there. Thank you.

Chairwoman MALONEY. Well, then, let me move on to the other regulators. Would you support a legislative change that granted

you similar authority to that of the Fed, to regulate substantive abuses by credit card issuers whom you have the authority to supervise?

You testified earlier, Mr. Dugan, that you did not have that power. Would you support such a legislative change?

Mr. DUGAN. Chairwoman Maloney, I take it you're asking about regulations to establish unfair and deceptive practice—

Chairwoman MALONEY. Right, exactly.

Mr. DUGAN.—more generally, which could be credit cards, could be something else.

Chairwoman MALONEY. Yes.

Mr. DUGAN. And as I have previously written to the committee, I do think that is something that could be useful for, not just the OCC, but for other banking regulators to have.

And the reason why I mention the others is that not only is it a useful tool, but so much of the time—credit cards are a good example, mortgage lending is another—you really have to do this on an across-the-board basis, and I think sometimes that each of the regulators could bring more of a perspective to bear, based on the institutions that they specifically regulate.

And so, that is something that I have supported, but I think it should be done across-the-board, and something that should be considered as a way to jointly regulate where that is appropriate.

Chairwoman MALONEY. Governor Mishkin, would you support such a change?

Mr. MISHKIN. I don't have a position on that issue.

Chairwoman MALONEY. Chairman Bair?

Ms. BAIR. Yes, the FDIC does—we do think it would be helpful to have rulemaking authority under the unfair and deceptive acts and practices authority, as it would apply to our own banks.

I agree with John. I think, as a practical matter, that it would be done and should be done on an inter-agency basis. If we were given rulemaking authority, that would increase our ability to have a seat at the table, if you will, to initiate such rulemaking.

Chairwoman MALONEY. Director Reich?

Mr. REICH. Well, I agree with the comments that Chairwoman Bair just made about the rulemaking authority on an inter-agency basis.

I also agree with a comment that you made in your opening statement, that market-based solutions are a very important part of, hopefully, resolving many of the practices which we're talking about today. I think, clearly, there is a demonstrated need for the development of a set of best practices.

And my own preference would be that many of the problem areas that we're talking about would be resolved through the adoption—through letting the market work, the adoption of market-based practices, rather than attempting to pass regulations to deal with every single area of perceived difficulty.

Chairwoman MALONEY. And Ms. Johnson?

Ms. JOHNSON. Yes. If given that authority, we would work with our inter-agency colleagues to implement.

Chairwoman MALONEY. And I would like to ask the regulators, and Mr. Neiman, what abusive practices would you start cracking down on first? What would you target?

Mr. NEIMAN. Well, I would—because the State's hands are tied, I would look at many of the abusive practices which can be the most troubling practices that you have talked about today: universal default; double-cycle billing; and late fees after credit limits are exceeded.

I would look to restoring the balance, either returning power to the States to address these issues, but we would also support a national standard, whether through a legislative approach, or working with our colleagues at the regulatory level.

Chairwoman MALONEY. My time is up, and I—Mr. Castle, or Mr. Bachus? Who is—Mr. Bachus?

Mr. BACHUS. Thank you. Governor Mishkin, in your statement you say, "Further, there are concerns that issuers' methods of calculating interest, such as the ways they choose to allocate customers' payments to different balances, are confusing or not clearly disclosed."

And what you are referring to is what I mentioned in my opening statement, where the credit card issuers charge different interest rates for different purchases or cash transactions.

And you go on to say, "The presence in the market of terms seemingly unfavorable to the consumer." Now, it would obviously be always unfavorable to the consumer to target that to the balance where there is either no interest rate, or where there is a low interest rate instead of the high interest rate. That is never going to be anything but unfavorable to the consumer, or unfair.

You say here, "The presence in the market of terms seemingly unfavorable to consumers appears to indicate that the market is not fully competitive." Is that one of the practices that you were referring to?

Mr. MISHKIN. In terms of getting a market to be competitive, consumers have to have the information that actually lets them make an informed decision. And one of the things that our proposal does is it makes it much clearer—and also, for me, in much larger print, which is a great help, in terms of getting older, and not being able to see as well—that it makes it much clearer that, in fact, this is the way that the payments will be allocated.

Mr. BACHUS. Right.

Mr. MISHKIN. I think the benefit of that is that competition then can start to work. That, in fact, if one credit card issuer is not giving a consumer as good a deal, then consumers, if they know this, can actually shop around and get a better product.

And, in fact, the information that we see being provided about this, including congressional hearings like this, are actually helping to change industry practices in a positive way.

Mr. BACHUS. Yes. You know, all of you are regulators, and part of your duty is to listen to consumers, those that utilize your institutions. When they come to you with a complaint that their payments are going to their balance with the lowest interest rates, which is always unfavorable to them, is there any public interest argument that you can give them, why that would be so?

Or even say this: Is there a risk-based reason that a card issuer would not allow their customers to pay off the amounts on their higher interest balances first? It seems to me that it's a safety and soundness issue. Any time they applied on the low interest rate,

they increase the likelihood that the consumer will default, and increase the difficulty of them paying their obligation. But—

Mr. DUGAN. Mr. Bachus, this is an issue, in terms of disclosure, that the OCC did address in its guidance with respect to national banks, in the sense that we did not feel that national banks were adequately disclosing when they were always making the payments to the lower balances first.

And so, we have directed, through our guidance, that we expect our banks to make that disclosure clear. And we are gratified that, in the proposed change to Reg Z, everybody may—

Mr. BACHUS. Yes. Let's say even if you say, "Make that clear," but that still doesn't—even if they make it clear, these disclosures—even the Fed's proposal, and what they are going to do, I mean, that is better than now. But it is still pretty complex.

But I guess I would ask each and every one of you, does applying it to the low interest balance increase the likelihood of them defaulting or not?

You know, one of the things that you all are trying to do is encourage people to pay off their credit card debts. We all agree that credit card debt in this country is problematic. It seems to me that this practice just increases default rates, and increases consumer debt loads. I mean, even in the Fed statement, you say that it is certainly unfavorable to consumers.

Is there any safety and soundness or risk-based reason to do that? Or is it just to increase your profits? That is the only thing to me, the only justification to me is just to increase—there is nothing favorable about it.

Mr. DUGAN. Mr. Bachus, I think that is a question you should ask the issuers on the issuer panel. But as to whether it is a safety and soundness risk, we do monitor, from a safety and soundness perspective, how issuers are managing their accounts more generally. We look very carefully at those kinds of rules. And we believe they have been able to manage the risk associated, even with payments like that.

We do think it's important that they disclose it correctly. But going beyond that is not something that we felt that we had the authority to address.

Mr. BACHUS. Okay.

Ms. BAIR. Well, I would say, with regard to the specific instance that you mentioned, I would have a hard time seeing a public policy basis for that type of allocation.

It sounds like there were two problems: one, the consumer wasn't given adequate notice that this payment was going to be treated as a cash advance at the higher interest payment; and then, two, to add insult to injury, when he made the payment, it was applied to a lower interest balance.

We are carefully looking at this. I would say one argument—now, I am fact finding, but one argument that has been made to me with regard to the question of the zero balance transfers—is that when you have a zero balance transfer situation, and the payments are applied there first, the economics of that helps facilitate providing the zero balance transfer deals.

Now, whether that outweighs some of the other issues, I don't know. But that is one situation where a public policy argument has

been made to me that this type of tiered payment allocation facilitates these very low interest transfers to consumers.

Chairwoman MALONEY. Time has expired. Mr. Watt, for 5 minutes.

Mr. WATT. Thank you, Madam Chairwoman. Ms. Bair, there are two parts of your written testimony that I want to focus on, because they are very troubling.

One is on page 6, where you talk about the 27 institutions the FDIC has identified as credit card lending specialists. First of all, before I forget it, would you provide a list of those institutions to the committee?

Ms. BAIR. Yes, I would be happy to.

Mr. WATT. And you go on to say that credit card lenders—those 27, I presume—had a return on assets of 3.7 percent in the first quarter of 2007, while the banking industry, overall, had a return on assets of 1.21 percent.

And in the first quarter of 2007, the ratio of non-interest income, which includes fee income, the average assets was 9.61 percent for those 27 credit card specialists, versus 2.09 percent for all insured banks and thrifts.

Ms. BAIR. Yes.

Mr. WATT. Then, on page 17 of your written testimony, you introduce a concept that I really hadn't focused on, this subprime credit card. I never really had made a distinction between prime and subprime credit card lenders. We make that distinction in the mortgage field all the time.

Are these 27 institutions that you identify on page 6 the primary subprime credit card lenders that you're talking about on page 17?

Ms. BAIR. No.

Mr. WATT. Or are they two different groups of people that you are talking about?

Ms. BAIR. No, I believe—I will check with our economist—this is for the industry, as a whole. We went to—

Mr. WATT. Okay, how many subprime credit card lenders have you all identified, and could you provide the committee a list of those—

Ms. BAIR. Yes, I would be happy to do that.

Mr. WATT.—subprime credit card lenders, if it is different than the credit card lending specialists?

Ms. BAIR. It would be a different group, and yes, I would be happy to provide—

Mr. WATT. Okay. There would be some overlap, I presume.

Ms. BAIR. Yes, yes. On page six, we are talking about the industry as a whole, those who specialize in—

Mr. WATT. Okay. Now, the question I want to ask is are you telling me that the FDIC does not have any authority to address that kind of disparity in returns?

You are talking about 9.6 percent of a credit card specialist income coming from fees or non-interest. I mean, it seems to me that there is something wrong with that picture.

And so, my question is, is there anything that you have done, or can do, to address that kind of disparity?

And can you have a set of rules that is more aggressive for subprime lenders, just like we are talking about in the mortgage

area, this notion that we have to have one set of rules that fits everybody, when the violations don't seem to square up on both sides of the ledger, it seems to me to be a misconception.

Do you have anything that you can do to those people who seem to be abusing the system?

Ms. BAIR. Well, first of all, I would like to say this is for the industry, as a whole. FDIC-supervised institutions are only about 15 percent of the market. And—

Mr. WATT. So, then that is in Mr. Mishkin's territory, is what you are saying. And what I keep hearing all of you saying is that the Fed hasn't done squat to really deal with this problem, and doesn't seem to be doing squat to deal with it, even though they are the only ones that have the authority to do it.

So I am going to—I have 1 more minute, and I have my soap box here, and you got me on it. Let me talk about my other primary complaint, which is you all talk about risk-based pricing. I have absolutely no problem with risk-based pricing. The problem that I see is that nobody is assessing the risk out there.

When I see my father, after he died, getting all of these solicitations, I mean, I would not have given my father credit on a credit card. I am serious. It is not your assessment of risk, you have to assess some risk before you can do risk-based pricing. Isn't that right?

Is anybody assessing risk in the credit card industry any more, or are they just mailing out and sending the credit card to whomever will fill out an application and send it back in, unsolicited?

Mr. DUGAN. Mr. Watt, they are assessing the risk. I mean, if they are not, they would have a fundamental problem with us, because—

Mr. WATT. Well, we have a fundamental problem here, because there is—you know, these people are just sending out credit cards and making money on fees, rather than interest.

I don't have any problem with people making money on interest. At least that is a fair way that has been disclosed to everybody. But when they are not assessing the risk, and they are just building those defaults into—and charging everybody else who is paying for it, without any distinction, that is where I get really troubled about the practices that are going on here.

Mr. DUGAN. If I could just follow up on the subprime point that you had before, there are—the OCC has had a number of institutions in the past that were engaged in subprime credit card lending. We found a number of problems on the unfair and deceptive side that rose to the level where we took a number of strong enforcement actions that resulted in quite a lot of—multi-hundreds of millions of dollars—returned to consumers.

The fact is, now, as it is the same with subprime lending in the mortgage business, we don't have a lot of subprime credit card lending, because we have not been—

Mr. WATT. Well, somebody does.

Mr. DUGAN. And that may—

Mr. WATT. Who has it?

Mr. DUGAN. I cannot answer that question. I can only speak for—

Mr. WATT. Maybe the Fed can tell us.

Chairwoman MALONEY. We are going to break for 10 minutes to run for votes, and I am going to ask the panelists to come back. Many people have more questions. Thank you very much.

[Recess]

Chairwoman MALONEY. I would like to ask Governor Mishkin. We have heard everyone on this panel, on both sides of the aisle, talk about the challenge that we face, the really—almost a crisis in the credit card industry. And many people have testified that you are the only one that has the authority at this point to do anything about it.

I want to compliment the Fed for the truly outstanding leadership that you put forward in the subprime guidance. It was tremendously measured, helpful. It is being implemented, it is correcting the problem. Why are you not moving forward with guidance on credit cards?

You have the authority to do it. Everyone is testifying there is a problem. From your prior testimony, it sounds like you have no intention of coming forward with guidance or regulation in this area.

Mr. MISHKIN. I would not characterize it to say we have no intention of going further, that we—

Chairwoman MALONEY. I am pleased to—

Mr. MISHKIN. We do want to make sure that we take the appropriate steps at the right time. And we are very open to thinking hard about these problems in order to make this market work better.

The credit card market is incredibly important to the American consumer. And, in fact, we very much want to have a situation where the markets work well, and that the consumer is actually being served well.

So we feel that our disclosure proposal is a major step in the right direction. I think it is a very great improvement over what was there before, and we certainly will keep an open mind to try to make this market work as well as it possibly can.

Chairwoman MALONEY. Well, my colleagues join me in thanking you for the Reg Z. It is a major step forward. But we are hearing from all of the regulators today, and the members on both sides of the aisle, that it does not correct abusive practices. I would urge the Fed to consider coming forward with guidance, and taking further steps in that direction.

I will now call on my good friend and colleague from the great State of New York, Gary Ackerman.

Mr. ACKERMAN. I thank the chairwoman, and again, thank you for calling this very important hearing.

You are the people who do the regulating, and the overseeing, and the supervising of the industry, which certainly needs all of that. And it is very frustrating to hear of all the abuses and things that are going on that just seem outright unfair and confusing and misleading, very often, to so many consumers.

It was said this morning during the testimony that competition is good for fairness, and, indeed, hopefully it is. But sometimes, all the competition is to see who can one-up the other on coming up with some kind of complicated scheme that does not put all the information out in front of the public.

And there has been some information to make a decision is absolutely essential for consumers getting a better deal. And that is true, also. But in practice, it is highly questionable as to what is really happening out there.

I was actually going to do this with the next panel. But thinking about it, I seem to have a credit card, or been doing business with everybody that is representing one firm or another. So I thought otherwise. So you are stuck with this.

This is stuff that I get. This is just me. These are just solicitations, every one of them a credit card. I'm a member of the Financial Services Committee, and I used to teach mathematics, and I was going to ask this of the next panel, because all this stuff, all the information is in every one of them. They disclose everything, and you really do need a magnifying glass with some of the type, and it is impossible to find, but sometimes there is an asterisk. You know, there are footnotes, and then you can't find the footnotes for three pages. And tell me if anybody is going to read this.

But you are all smart people, and you are regulating the industry, so I am going to give you, as my grandmother used to say, "a for-instance." So, if you have a pencil and paper, that would be good. If you have a calculator or a—one of those Black Berrys with a calculator in it, that's fair. Anything you want, a computer, you can consult with a friend, call anybody on your cell phone. You can poll the audience and come up with—

[Laughter]

Mr. ACKERMAN. But here is the question that I face, all right? I have a credit card with a limit of $7,500, and I owe $4,200 on that credit card, and I am paying a great rate of 6.5 percent.

And I get this offer, you see, and the offer gives me this—right on the envelope, tells me all sorts of things, and then tells me some other things and different things, and it offers me a great interest rate, some of us call it a sucker rate, but it is a come-on kind of a rate of 3.99 percent for a new credit card for 6 months. And then, after that, they tell me I am going to have to pay 8.74 percent interest.

There is also a transaction fee in small print on the next page of 3 percent. Now, those transaction fees don't figure into interest rates, so they really change the name. This is one of those New York, you know, shell games, where you can't figure out what's going on, because it's happening so quick.

So, the transition rate is not considered an interest rate, so you all don't take into consideration. I have to figure out, because I have to pay it in cold cash, whatever they call it.

But I do know that if you charge me a 3 percent transition fee, and I pay it off quick—let's say in one day—I know that 3 percent, if it was on an annualized basis, would be 3 times 365 days in a year, which, in a non-leap-year year of 365 days would be 1,095 percent, almost 1,100 percent if I paid it off. And the quicker I pay it off, the more money it is.

So, if I pay it off slower to amortize that 3 percent fee, I get a better deal on an annualized rate, if it was a rate. But then again, I get trapped into when they jack the rate up to 8.74 percent, and I was only paying 6.5 percent.

So, my question is, if I take one full year to pay it off, and pay it off 100 percent after the first year, having transferred my balance of $4,200 at 65 percent at the rate of 3.99 for 6 months, and then paid the 8.74 for the rest of the year, what interest rate would I be paying? Anybody? I only have 5 minutes.

[Laughter]

Mr. ACKERMAN. Time is running out. Would I be paying more at the end of that, than if I left it at my original 6.5 percent? And that is the dilemma. I withdraw the question.

[Laughter]

Mr. ACKERMAN. I didn't want to embarrass the people who have all this power over me, and send me all this great information to help me make these informed decisions, because they're my good friends. I know that because they write me so often.

[Laughter]

Mr. ACKERMAN. But therein lies the dilemma. What is a poor consumer to do? There is something wrong with the interest industry.

Take underwear, for example. Some people think it is not an option. So you go and buy it in a place like Sears. And you go in there, and they are selling underwear. But someone comes over to you with a clipboard and says, "If you take out our credit card, you get 15 percent off today, everything you buy."

So, you fill out the form, and they approve your credit really quick, because they do this great investigation of you, and you are worthy of having underwear, at least, and they charge you an interest rate of 24.9 percent. You got 15 percent off of the total price, but you are still paying 24.9 percent.

How much do you think they make on the underwear? It is something obscene when you are making more money on the charge card than you are on the underwear. It seems that the retail business has caught on that there is more money in the interest, in the credit card industry, than in the retail business.

The underwear is an excuse to charge you interest. They are not selling underwear; they are selling credit. And, unfortunately, in today's retail industry, you are going to be paying interest long after that underwear wears out.

Chairwoman MALONEY. I grant the gentleman 60 additional seconds.

[Laughter]

Mr. ACKERMAN. Well, I thank the generosity of the—I bought the underwear anyway, so don't be concerned.

Does anybody have a response to what is going on? And this is not a way to inform a consumer. There is no way, when you have a system of fees that is not put into the structure, and everybody comes up with it's a 3-month deal, or it's a 6-month deal, or no interest for a year, and there is no correlation.

I am introducing legislation that would say, basically, that you have to divulge what the annualized rate would be, as if it were all interest when you charge a transaction fee. Is there any response to that?

[No response]

Mr. ACKERMAN. You all are not regulating that, it seems to me.

Mr. MISHKIN. Let me just add that I think one of the very key things we did in this proposal is to actually make it very clear what the fees are. And our consumer testing indicated to us—

Mr. ACKERMAN. What the fees are, but it is clear what the fees are. The fees are 3 percent, if you have a magnifying glass, usually. A lot of institutions are capping it now, at a specific dollar amount.

But there is no way for the average consumer to translate that, as we did with mortgages, and say, "Everything has to be expressed in an annualized way so that people can compare apples to apples," and there were—we all know about points and this and that, that don't seem to fit into the—but is there going to be an addressing of this, or do we have to do that? Because the regulatory industry is not.

Chairwoman MALONEY. Mr. Mishkin?

Mr. MISHKIN. One of the things that our consumer testing found is that consumers really reacted very strongly to information about fees, and that, in fact, the sticker shock from getting information about the fees really did have a big impact on their understanding of the cost of using credit.

And this is one of the reasons why we felt that focusing on a separate box on fees, which was a change from what was before—and also, on periodic statements, making it clear to people what the fees have been, and accumulating it for them—actually can make a big difference, in terms of them understanding—

Mr. ACKERMAN. If the Chair would just indulge me another—

Chairwoman MALONEY. So granted.

Mr. ACKERMAN. If you completely divulge it in, you know, 72 point, bold, chartreuse type, it still doesn't help the consumer, because each of the credit card companies will inform them, but one will give the deal for 3 months, one for 6 months, one for 9 months, and nobody annualizes it.

And just as you were not able to, and I am not able to—unless we had a lot of time on our hands—figure out, there is no way to compare it. You know, 3 months at 3 percent, or 6 months at 2 percent, or a year—you know, what does it boil down to for me in dollars is really what consumers need to know.

And it would be a simple thing to do that, because they have come up with these methods of expressing and divulging so that you can't figure it out and compare it quickly. But if everybody had to express it in the same term, "This is what it costs you for a year for this money, fees and everything, on an annualized basis, whether you take it out for 3 months or a year, or forever," that's what you should be doing.

Chairwoman MALONEY. Is there any response? And then Mr. Green.

[No response]

Mr. ACKERMAN. Thank you very much for your interest.

[Laughter]

Chairwoman MALONEY. Mr. Green?

Mr. GREEN. Thank you, Madam Chairwoman, and I also thank the ranking member, and, in his absence, Ranking Member Bachus for his comments. I too will associate myself with the comments that have been made this morning.

It appears that there really is bipartisanship on this committee, especially as it relates to the concerns that are being raised today.

Let me start by asking if everyone agrees with the recommendations of Mr. Mishkin. Am I pronouncing your name correctly, sir? Mr. Mishkin, of the Board of Governors? Does everybody agree with his recommendations? Is there someone who is of the opinion that he has gone too far, or that he hasn't gone far enough?

Mr. DUGAN. It is an 800-page proposal, and it came out last week. We have looked at it preliminarily, and we like many of the things in it, but—

Mr. GREEN. That is typically the way we do business here.

[Laughter]

Mr. DUGAN. I think that we are likely to recommend some other additional changes, as we have done in the past. But that is one of the things we are studying right now.

For example, we have talked, as I talked about in my testimony, I think we would like to see the Federal Reserve explore the possibility—to the extent that rate changes are made, and they are applied to existing balances, most issuers—or at least most large national bank issuers—provide an opt-out to consumers, and now you have 45 days to look at that.

But not all do; it is not required. I think it would be a question about whether that would be something to apply across-the-board, to put more of an element of fairness across-the-board. So it's that kind of thing. There are a couple of other things.

But, generally, this is a very positive proposal, not just for what was required to be disclosed, but the way in which it is required to be disclosed, in a simpler, more standardized format.

Mr. GREEN. The opt-out provision, is that something that everyone finds acceptable? Who has a concern with an opt-out provision? Anyone?

Ms. BAIR. No, I think that would be a good addition, to make sure that if consumers do want to opt out, if they are given advance notice of a rate change, that they can continue making minimum payments to pay off that balance. I think that is actually crucial for the opt-out to be meaningful. So I think that is an excellent suggestion by OCC.

Mr. GREEN. Is there any aspect of this, including the universal default, the retroactive application of increased rates, the double-cycle billing, paying late by paying on the same day but not within a certain timeframe on the same day, is there any aspect of this that you find abhorrent, to the extent that it is invidious, to the extent that you think it shouldn't exist?

Mr. REICH. There may be situations where credit card lenders may be justified in taking an action that may look something like universal default. And that might involve bankruptcy, situations where a bankruptcy occurs, or a mortgage foreclosure occurs, that a credit card company may be justified in making an immediate rate adjustment, based on information that becomes known to them.

And that might look like a universal default situation, and it makes me a little bit nervous when we start talking about prohibitions, blanket prohibitions, that we may be initiating a situation where there would be unintended consequences.

Mr. GREEN. If you have multiple credit cards, conceivably you could have multiple—and all of your payments would be on the same date—conceivably, you could have different times on the same date to make your payments. I assume that everyone agrees with this premise: multiple cards; same date to pay, but you could have different times on the same date.

Would it be helpful to at least have a certain time on the date that the payment is due? Such that if you have five cards, you don't find yourself with five different dates. Maybe not likely, but it conceivably could happen.

Is there any way for the industry to do some introspection and conclude that maybe this is something that we can work together on, so that we don't have people who are Internet-savvy, who like to do things on the Internet, they do it on the last day, and it is understandable now, people do this on the last day, they pay. And they think that they paid timely, but they find out that there is a certain time on that date that you must pay within. Any comments, please.

Mr. MISHKIN. In our proposal, we actually do have a requirement that the time of day is actually specified, so it does address the issue that you have been talking about.

Mr. GREEN. Specified? Give me a little bit more information, please.

Mr. MISHKIN. It says when payment is due; it tells you exactly the time, as well.

Mr. GREEN. This is for each card—each card issuer would have a specified date that would be made available and known to the consumer?

Mr. MISHKIN. Yes.

Mr. GREEN. Here is the dilemma, if there is one. It is this: You have—some people have 10 credit cards. I don't advise it. In my opinion, if you have one, you probably have about all you need, for me anyway, in my—

Chairwoman MALONEY. I grant the gentleman 60 more seconds.

Mr. GREEN. Thank you, and I will wrap it up quickly. But would it not be helpful if we—if everybody agreed that at a certain time on a certain date, that this would be a good thing, to have the card holder pay by, as opposed to 12:00, 5:00, 8:00, 11:00, all on the same day? Do you follow me?

Because you can give the time, but if everybody gets a different time, I think that that does cause a little bit of confusion with the consumer, and it would be great—most consumers, by the way, think that midnight is probably the time. If I can pay it by midnight on the date that it is due, I have paid timely. Most don't realize that there is another time.

Thank you, Madam Chairwoman. You have been generous with the time. I yield back.

Chairwoman MALONEY. Any comment?

[No response]

Chairwoman MALONEY. Okay. Mr. Gillmor?

Mr. GILLMOR. Thank you, Madam Chairwoman. Mr. Mishkin, I think the Fed has done very good work here. I have a question on the list of fees, and I think that is good to have that specific list.

But concerns have been raised that the list is exclusive. And could a side effect of this be generation of a lot of imaginative new fees that don't have to go on there? Will you comment on that concern?

Mr. MISHKIN. We had specified the types of fees that do have to be disclosed, because it is clear that these are fees that are extremely common in the industry.

One issue is we never know what kind of innovation we are going to have in the financial industry. It is extraordinary, what has happened in terms of who could imagine paying bills the way we pay them now, using the Internet, for example?

The problem is that we may not know what the actual new product is that is going to be provided. What we do want to make sure of is that when a person actually uses a new product, that the fee is disclosed to them at that time.

In fact, one concern we have is that if the only time that you get the fee disclosed to you is in writing is when you actually get the credit card, and 3 years later you are actually going to do something because you didn't think about it before, but you want to think about doing it now, we want to make sure that you get the fee disclosed to you at that time, so that you can make an informed decision at that time.

Mr. GILLMOR. Thank you. Mr. Neiman, you said that competition among credit card issuers has lowered average interest rates, but at the same time it has encouraged the expansion of fee-based profit.

Do you want to explain why you think that is happening? Is that because people can figure out the interest rate easier than they can figure out the fees?

Mr. NEIMAN. I don't remember the reference in the testimony you are referring to, but I think one of the concerns—and I think with the over-expansion—the greater competition—and I think Comptroller Dugan talked about the expansion of credit cards as a result of risk-based pricing, as well as the securitization process.

But I think that the flip side of that is a greater responsibility on the issuance of those cards by the issuers, both with respect to an increased responsibility, and, I think, with respect to the ability of the borrower to pay. This is very similar to some of the issues that you are already addressing in the area of the subprime issue in the area, but I think it is critical, as well, in the expansion of credit card opportunities.

Mr. GILLMOR. Thank you. And, Chairwoman Bair, in your written testimony you noted a 40 percent decline in consumer complaints regarding credit cards over the past few years. Do you have any thoughts as to why?

Ms. BAIR. Well, those are just FDIC-received complaints. It is still a healthy percentage. Credit cards still generate a healthy percentage of our complaints. We think some of that may be charter transfers, that we don't have as many credit card issuers as we used to have. But because we don't track it, that is a guess. We are not really sure.

Mr. GILLMOR. Okay, thank you. I yield back.

Chairwoman MALONEY. Thank you. Congresswoman Waters.

Ms. WATERS. Thank you very much, Madam Chairwoman. I have to apologize. We had a Judiciary Subcommittee hearing going on at the same time, and so I have been back and forth. And the question that I truly wanted to ask should have been asked of the first panel, but—

Chairwoman MALONEY. This is the first panel.

Ms. WATERS. Oh.

Chairwoman MALONEY. The regulators.

Ms. WATERS. Is this still the first panel?

Chairwoman MALONEY. Yes, it is.

Ms. WATERS. Oh, this is who I wanted to ask a question. Okay, this is who I wanted.

Credit cards are an absolute almost-necessity. You cannot rent a car, you cannot make hotel reservations, and you cannot make flight reservations. You can get on the airplane, but if you pay cash you are profiled, and you are suspect. That is one of the indicators for those who think that they should take a closer look at people who are traveling, they may be traveling for criminal purposes, etc.

So, credit cards are pretty essential for daily life. And since they have evolved to that point, I really do think there should be more regulation.

And I am very, very concerned about this whole subprime credit card lending. Just as we have the problem with mortgages, and the defaults that we are looking at now, it seems as if we have these subprime credit card lenders who charge all kind of fees, and it seems to me there should be some regulation, or there should be some ceilings.

Okay, we know that no one is going to talk about a ceiling on interest rates, you can do what you want. But then, we get into late fees, and how late fees are charged. And this business about paying—your interest rate is going up if you are one day late, and all of that, I just really think we ought to look very closely at some of these fees, and start to talk about regulating fees.

For example, I think there perhaps should be regulation on the yearly fees that are charged. I think that if there are monthly fees—which there shouldn't be, but I understand that there are some lenders who have monthly kind of maintenance fees. And I do think that there should be a limit on how much you can increase the interest rates when you have determined that there is some additional risk involved.

Now, having said that, I would like to get some response. Who would like to talk about why there should or should not be more attention paid to this proliferation of fees, and perhaps some discussion about regulation? Let me start with—well, anybody. Who would like to respond?

[No response]

Ms. WATERS. Board of Governors, Mr. Frederic Mishkin?

Mr. MISHKIN. I think the issue of fees is very important.

Ms. WATERS. I cannot hear you.

Mr. MISHKIN. The issue of fees is very important. This is one of the reasons why, in our proposal, we stressed so much clear information about fees. We found, in our consumer testing, that this is something that really does have an impact on consumers' understanding of what is going on, and also in terms of their actions.

Ms. WATERS. I am maintaining that, even though you are moving to look at this, do something about it, I am going a bit further. I am talking about creating some discussion about the regulation of fees, above and beyond the basic interest rates that are charged.

Mr. MISHKIN. The only comment I would have here is that the issue about regulation, setting prices or maximum prices, is that we have to think very hard about the unintended consequences, and that in that context, something that first sounds like it will be very helpful could actually end up either—may mean the people who would like to get credit couldn't get it, or whether there would be other sorts of problems, or that markets that eventually could be very beneficial might not develop.

Ms. WATERS. But have you, Mr. Dugan, taken a look at the proliferation of the creation of fees?

It seems to me that there is a whole new business that is being offered to banks and financial institutions about the creation of new fees, how they can make more money.

And somewhere, I think I read that there were some financial institutions making more on fees than on their basic products. Have you given any thought to what we can do to slow down this proliferation of fees, or to contain them? And what do you think about the idea of regulating fees?

Mr. DUGAN. Ms. Waters, I would say a couple of things. One is, picking up on a question of Mr. Gillmor, I do think that the simpler disclosure of interest rates that this committee—this Schumer Box that showed interest rates—did have an effect over the years, in having a lot of competition and lowering the average rates.

And I think there hasn't been as good a disclosure, because we haven't updated Reg Z in 25 years, to show what these fees are. I think that's part of the benefit of this proposal, is that when we see them, they are clearly shown. They are shown not just in the initial thing, but in your periodic statements, and how much you have done each year.

I am hopeful, and I believe it will be the case, that there will be more competition about fees that consumers will have—

Ms. WATERS. Where do they show them, when they have decided that, despite the fact you started out as a good risk, that now you missed a day or two, and whatever their criteria is, they are going to increase those interest rates automatically? Where is that shown?

Mr. DUGAN. I don't think there is any requirement to—in the proposal—to show the reasons for it. They will show what the fees are that are being charged.

Ms. WATERS. You don't have to show the reasons for it, but Ms. Jones has been paying 15 percent, and then on her next billing she is now paying 20 percent or 30 percent. There has been no additional notice, no recall of anything that was told the person in the very beginning that, "Should you miss 5 days, or if you are 5 days late, you are going to get a late fee, plus we are going to increase your interest rates."

Nobody explains that. And all of a sudden, there is this increase.

Mr. DUGAN. Well—

Ms. WATERS. How do you deal with that?

Mr. DUGAN. Well, I think it is a real fundamental issue you are raising. And it partly is dealt with in the new proposal, in—

Ms. WATERS. How?

Mr. DUGAN. They have to give advance notice for any change in the fee, and it has to be 45 days, which is more than the 15 days under current law.

And, as I was saying earlier, most of the large issuers now will allow you to opt out of that increase, and close your account, and pay it off over time and go to get another credit card. So there is something that does address that directly.

Mr. NEIMAN. May I also respond to Congresswoman Waters—pick up on your point on the subprime offerings and the fees?

One of the earliest actions that New York took against a subprime credit issuer—remember, we only have a limited number of credit card issuers over which we have the ability to bring enforcement actions—but it was a case where they were—had issued a pre-approved premium card to a select group of borrowers, saying that, "You have been pre-approved for up to $2,500 in credit."

In reality, most of the borrowers had a credit limit of $300, and that was reduced by $150 in fees. An action was brought, and settled for $9 million in fines. And it just kind of highlights the types of concerns, and we share your concerns about having the ability to address those deceptive practices, as well as to bring enforcement actions.

And States often are in the best position to act quickly, as the industry changes and develops new products.

Chairwoman MALONEY. The gentlewoman's time has expired.

Ms. WATERS. Thank you.

Chairwoman MALONEY. Mr. Scott.

Mr. SCOTT. Thank you very much, Madam Chairwoman. This is truly a very, very revealing hearing, and it is much more serious than I thought. This borders on sophisticated predatory lending by a highly respected segment of our financial services industry with a product that certainly, without any equivocation—represents the actual key to life.

The credit card now is a key to life in our community. And credit card issuers are now bordering on being sophisticated predators. Let me just explain to you why I come to this conclusion.

First of all, we are dealing with a sophisticated way of building up penalty interest that hovers right now at an average of over 30 percent. That is number one.

Number two, companies are now applying payments to the least costly debt, thus forcing customers to pay more in interest. For example, a way of an industry practice that includes charging interest on debt that has already been paid. Let me give you an example.

If you go—and this is a common practice, this is why it is predatory, this is why it is deceptive and unfair, and down right low down—if you take—and here is a consumer who goes out and pays—and has a price of a product of $4,000, and he pays $3,000 of it right out, they charge the interest on the complete $4,000.

That is unmercifully pathetic, with this industry, to—when they pay their bill on time, you charge the interest on the entire amount

when he has already paid most of it. When the interest should be on just the $1,000, it is charged on the $4,000.

Now, you say the Fed has done something. What the Fed has done with this 15 to 45-day extension is absolutely insignificant, when you look at the depth of the abuses and the aggressive marketing and pricing packages that are done.

So what do we do about this? I would like to ask each of you—because I think that we need some serious regulation—I need Congress to reach in real deep and do some serious regulation of the industry, because again, the credit card is the key to life. We don't use cash any more; we are a credit card society. Everything is based on that, and we need them for emergencies.

So, I think we should do these things. I think we should cap penalty interest rate increases. Don't you agree? Good.

I think you should prohibit—we should prohibit—interest from being charged on late fees, or over-the-limit fees, and prohibit the late fees if a card issuer delays crediting a payment. Does that not make sense? Does that not get to it? What is this? This is a complicated language of a whole—almost worse than a foreign language.

I don't even understand it. Nobody reads that. All the people want is that credit card. You think they read that fine point? They don't read the big point. I don't know what it says and what it does. But I know this. You do. And your industry knows, and your industry knows that you are taking advantage of this.

You are taking advantage of the opportunities that are presented in a free enterprise system, where everybody is out here to make a profit. And how do you make a profit on this? You make a profit on the interest you charge on the credit. But where you're really making your money is in these late fees, and in these penalty fees.

And so, it just seems to me to be a pattern of doing these kinds of things. So I would like to get your comment. I mean, because if you do—if you—if we can bar companies—and again, like I said at the very beginning, I know many people in this industry, and they are good and decent people, and I really think that you are going to provide the leadership within your industry to clean this up, but it is our job to lay it out, examine it—

Chairwoman MALONEY. The Chair grants an additional 60 seconds.

Mr. SCOTT. Thank you so much, Madam Chairwoman. So I think that these are the things we need to do.

Ms. WATERS. Will the gentleman yield for 1 second? Over here, Mr. Scott? Will you please ask them to answer your questions about paying on the $4,000—

Mr. SCOTT. Oh, yes.

Ms. WATERS. The interest rates after you have paid already $3,000 of it. I really want to hear their answer.

Chairwoman MALONEY. Yes, let's hear their answer.

Mr. SCOTT. But I still need my 60 seconds, please. Go ahead.

[Laughter]

Mr. MISHKIN. People usually referred to this practice as double-cycle billing. One of the good things is that when light is shed on this, it creates a problem for the people who are doing it.

What we are seeing is that more and more—in fact, there are fewer and fewer credit card issuers who are actually doing this. The major credit card issuers have been dropping exactly this practice, because of the fact that it doesn't smell right to people.

So, I think that one of the key issues here is that the role of Congress is to shed light on this. We are trying to shed light on this through these disclosures. That actually helps make it possible for consumers to say, "We're not going to use a credit card that has this feature." And, indeed, then the industry actually starts providing better products.

Mr. SCOTT. That is why I say this is predatory, sophisticated predatory, because you know, by the very nature of your answer—

Chairwoman MALONEY. The gentleman's—

Mr. SCOTT. May I get my 60 second, please? Because I think that, number one, we have to bar companies from charging interest on debt paid by the due date. And you all agree with that. Any disagreement?

[No response]

Mr. SCOTT. We can include that? That would be very helpful.

Then, we need to cap the penalty interest rate increases. Any problem with that?

[No response]

Mr. SCOTT. Okay. Then, we need to prohibit interest from being charged on late fees, or over-the-limit fees, and prohibit late fees if a card issuer delays crediting a payment. I think those are things that we need to incorporate in the legislation. And I think that we will—

Chairwoman MALONEY. Thank you so much.

Mr. SCOTT. And I thank the chairwoman.

Chairwoman MALONEY. Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. I apologize for being late. I am doing the graduation tomorrow for the pages, so I stopped by the desk to chat with them, and told them that I had to go off to the committee, and told them what committee it was, and what we were talking about.

A young page, 17 years old, just told me that he has already received letters and applications for a credit card. Seventeen years old. He is a page. He gets a card every day to go downstairs to get a free meal. He can't pay a credit card. He said he just decided he didn't want to send it in. I just wanted to—I have the spirit of sharing, so I just wanted to share that.

My question is to OCC. Have you investigated, or taken any enforcement actions against a top-10 credit card issuer since the Providian case? And have you taken any action against a credit card issuer for a consumer-related problem since 2003?

Mr. DUGAN. The answer to your question is we have taken a number of enforcement actions for unfair and deceptive practices in the credit card industry, generally, particularly on the subprime side. And the—as a result of the enforcement actions that we have taken, which is on consumer issues, not on safety and soundness issues, there are very few subprime credit card lenders left in the national banking system.

In terms of large bank issuers, our actions have tended to be more through the process of supervision and through our account

management guidance, and through—for example, the agencies got together and found that consumers were not being charged—were being charged very small minimum payments, to the point where it wasn't covering the interest each month, and the debt was growing, even though they would make a minimum payment. They would get deeper in debt after they made a required minimum payment.

We believe that raised both safety and soundness and consumer protection problems. And so, the agencies issued guidance to stop that. It took a while for the industry to adjust to it, and we felt the need to go out and demand that each of our issuers pay all finance charges, plus 1 percent of principal, so that a consumer, when they made a payment, would move his way out of debt—his or her way out of debt—and not get deeper into debt.

Mr. CLEAVER. Okay, thank you. So the answer is no?

Mr. DUGAN. Well, to which question?

Mr. CLEAVER. Well, actually, to both of them. You know—

Mr. DUGAN. We have taken enforcement action since 2003.

Mr. CLEAVER. Against? Against?

Mr. DUGAN. And we have—

Mr. CLEAVER. Against one of the top 10 credit card—

Mr. DUGAN. Not against the top 10, not a formal enforcement action. The answer is no to that question.

Mr. CLEAVER. Okay. The—do you have any reason for not having done so?

I mean, you mention the subprime credit, and we all have problems with them. I think what you are hearing is that there are problems with some of the non-subprime credit card lenders. And I think for us to pile on the subprime lenders is not quite at least where I am coming from.

I want to know about—I mean, this young kid, I won't call the name, he didn't get an application from, "Come Get it Credit Company," you know, it was one of the top 10.

Mr. DUGAN. Mr. Cleaver, we, in fact, have taken a number of informal actions, and we have a range of tools, as I tried to lay out in our testimony, where we address practices, and try to get changes made through the supervisory process, through informal actions, through matters requiring attention, through so-called safety and soundness orders, which is a little bit of a misnomer, because it includes consumer protection issues, as well.

So, we have taken a range of action, with respect to our large credit card providers, all of which are outlined in the testimony. And even though we haven't gone to the last resort of taking a formal enforcement action, it does not mean that we haven't had a rigorous supervisory program to address practices consistent with the law that is in place, with what is required in the Reg Z and the consumer protection responsibilities.

And when we see a practice that rises to an unfair and deceptive action, even though we don't have rulemaking authority, we do not hesitate to take enforcement action in the area, and we have done so.

Mr. CLEAVER. Thank you very kindly. I will yield back the balance of my time.

Chairwoman MALONEY. Thank you. Mr. Ellison?

Mr. ELLISON. Madam Chairwoman, thank you for your calling this hearing together. It is excellent.

Ms. Bair, could you tell me, if credit cards are being sent to everyone—or not everyone, but a lot of people, including my 19-year-old son—how can it be that the industry can sort of claim that they have to increase rates in order to adjust for risk? I mean, it seems like it's self-imposed risk, when you make credit cards so available to everybody. Can you help me understand that?

Ms. BAIR. I think that is a good question, and it is something that we are evaluating, as well. I will tell that when my son was 9 years old, he once got a credit card application, so I am there with you.

Mr. ELLISON. I am not surprised.

Ms. BAIR. And I used to teach at the University of Massachusetts, and I saw my students getting solicitations and getting in over their head on credit card debt. So I do think it is troubling.

And, clearly, the business model has been to make it widely available, and risk-base price it, and we have run into some problems with young people and others who do not have a lot of financial history of dealing with financial matters getting themselves into trouble.

So, I do not have an answer, but I share your concern.

Mr. ELLISON. Yes. I appreciate you saying that, because I mean, I think that for an industry to say, "Well, we have to have these rates because it's so risky," and then they send cards everywhere, it's just sort of disingenuous.

Let me also ask this question. Is part of the problem lax enforcement? I was somewhat surprised to hear that the top 10 have not received any enforcement action. Do you feel that, as regulators, you have enough resources to really hold the top 10 credit card companies accountable for questionable practices like double-cycle billing, you know, universal default, all these kinds of things? Do you have enough resources to do your job?

Mr. DUGAN. Yes, I think—well, speaking for the OCC, I—

Mr. ELLISON. Well, thank you, because I am now shocked that you are not doing it.

Mr. DUGAN. Well, you mentioned double-cycle billing. That is lawful.

Mr. ELLISON. Well, I mean, let me ask you this. Do you think that there are practices that are, in fact, technically lawful, but sort of stretch the spirit of the law?

I mean, if you are there to protect the industry and protect consumers as well, I mean, there might be some things that are lawful, but still, kind of beyond the pale. I mean, there is a—

Mr. DUGAN. I absolutely agree with that. I think that is what I was trying to describe—

Mr. ELLISON. Okay, okay. Please. Because I only have 5 minutes, that is why I am—

Mr. DUGAN. I understand that. But what I was trying to get at before is, for example, this minimum payment requirement that I talked about.

Mr. ELLISON. Right.

Mr. DUGAN. That was something that we imposed—"we," on an inter-agency basis, wasn't strictly required specifically in the law.

We believed it was an inappropriate practice, both for the consumer, and from a safety and soundness perspective. We took direct action, had plenty of resources to do it. That is number one.

Number two, I think it is a mistake to think only in terms of enforcement actions. What we do and how we achieve change, with respect to the providers goes through the entire supervisory process, and—

Mr. ELLISON. And I don't—

Mr. DUGAN.—there are many, many things that we bring—

Mr. ELLISON. Forgive me for jumping in, but I appreciate that. We shouldn't think only in terms of enforcement actions, but it seems to me that we should at least sometimes think in terms of enforcement actions.

And what I have heard is that there really haven't been any for the top 10, which creates certain interesting points of view, because it's like, wow, I mean, if you are a small credit card company doing sort of questionable practices, you are going to get scrutiny, and if you are a big one, you are not. So, I just—

Mr. DUGAN. I disagree with that.

Mr. ELLISON. Well, I mean—

Mr. DUGAN. Because they get plenty of scrutiny—

Mr. ELLISON. Well, wait a minute. Wait a minute. You said there were enforcement actions on the little guys, but not the big ones.

Mr. DUGAN. Not because they are little or big, it is because of what practices they engage in, where—

Mr. ELLISON. Excuse me. The next question I have is about pre-emption. I don't like Federal pre-emption, because I want more eyes on the problem, and I think that State attorneys general can help bring forth a level of accountability that sometimes our Federal Government doesn't think—well, I won't even say if that is the case—but for one reason or another, it doesn't provide.

Mr. Neiman, do you have any views on this subject?

Mr. NEIMAN. Yes, I certainly do. I mean, I question whether Federal regulators would ever have sufficient resources—or sometimes incentives—to take the actions that are necessary to—with respect to enforcement, and even the number of resources necessary to handle customer complaints.

I do strongly feel that the States are in a much better position to address these at a local level. That is why we have local police forces, and don't rely on county and State and Federal police, because local police are closer to the community. They understand the issues better, and they can react more quickly.

Mr. ELLISON. So—

Mr. NEIMAN. I think there are other models out there, like the FTC, as well as the EPA, where both Federal and State regulators—

Mr. ELLISON. I think the dual system of regulation is a good one, and I would be a very strong proponent of allowing the States to stay in the game, here, and in fact, expanding State ability to protect consumers in the area of financial services.

Chairwoman MALONEY. You raised some very important points, and your time has expired. And I would like to note, for the record, that there will be a hearing next week on June 13th on Federal pre-emption, so we can raise this issue and discuss it further.

I do have more questions, but in the interest of time, I am going to be placing them in writing to the panelists. I thank them for their time, and their testimony. I urge my colleagues to likewise place their additional questions in writing. And without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses, and to place additional comments that they would like into the official record.

This panel is closed. We thank you for your testimony, your time. And the second panel is called. Thank you.

[Recess]

Chairwoman MALONEY. I would like to recognize and introduce the second panel: Kathleen Keest, from the Center for Responsible Lending; James Huizinga, from Sidley Austin; John Carey, chief administrative officer of Citi Cards; William Caywood, senior consumer credit risk and compliance officer for Bank of America; John Finneran, general counsel for Capital One; Marilyn Landis, vice chair of the National Small Business Association; and Ed Mierzwinski, consumer program director for the United States Public Interest Research Group.

I thank you all for coming, and for your testimony. And would you please begin, Ms. Keest? Thank you.

STATEMENT OF KATHLEEN E. KEEST, SENIOR POLICY COUNSEL, CENTER FOR RESPONSIBLE LENDING

Ms. KEEST. Thank you for inviting me to talk today about the rules that the Fed has proposed to govern the disclosures in this marketplace that you have made very clear affects all of your constituents today to the tune of about $800 billion.

And I wanted to start with a reminder that truth in lending was—at the time it was enacted—enacted as a complement to substantive consumer protection regulations, not as a substitute for it. And the rules—as much of an improvement as they are—that have been proposed by the Fed don't offer that adequate substitute.

In looking over the rules, we looked at three questions. One was how are the disclosures going to be made? And we give the Board very high marks for that. The improvements in the way that the disclosures are going to be made are a vast improvement, and we commend them for it.

We also commend them for adding the 45-day advance notice to the imposition of the penalty fees. Although, as you have all highlighted, that certainly doesn't solve the problem.

The second question was, what is to be disclosed under the new regulation? And we have a lot of more concerns about that. As everybody has recognized, there is extraordinary pricing complexity here that challenged the ability of disclosures to handle the problem. There are opaque and complicated accounting systems, and there is a proliferation of fees.

And, as we found out today, that is a serious problem now, and that was the problem 40 years ago, when Truth in Lending was enacted. What we feel is the problem with the regulation is that—the regulation that has been proposed—is that, 40 years ago, Truth in Lending was enacted to standardize the price tag so that people could make order out of the chaotic pricing. And what we feel has

happened is that the Board has given in to the pricing chaos, rather than reigning it in.

The accounting problems that people have all talked about that are unfair—and there is a law against unfairness now—have not been dealt adequately with in the regulations, although with some of them there are some improvements. But with some of them, not at all. In fact, like the double-cycle billing, they basically just threw up their hands and said, "We can't deal with this, this way."

With respect to the problems that were enacted with that comparative price tag that you need, the Board is offering two alternatives. One is, again, simply to give it up as too complex. And that certainly is not an adequate alternative, and is certainly not going to solve the problem.

The other, as they recognized, if you actually paid a little attention to coming up with something that is consistent and descriptive, people can use it, and they propose that as an alternative, but we fear that they aren't going to—we fear that they don't favor that alternative.

And that brings us to the last question, which most of you have been focusing on already today, which is whether it is enough.

Duncan MacDonald, who was a former city executive, has written in, "The American Banker," that this is an industry that has lost its way, and the regulators haven't helped it regain its way.

We heard many times today about the unintended consequences of regulation. But unintended consequences flow from insufficient regulation, as well. And we fear that the Fed, with as much improvement as it has had, by its refusal to go further and using its unfairness regulatory authority, is leaving Congress with the job of curing some of these abuses that we have seen today. Thank you.

[The prepared statement of Ms. Keest can be found on page 208 of the appendix.]

Chairwoman MALONEY. Thank you very much.

Mr. Huizinga?

STATEMENT OF JAMES A. HUIZINGA, SIDLEY AUSTIN LLP

Mr. HUIZINGA. Good afternoon, Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee. My name is Jim Huizinga, and I am a partner in the Washington, D.C., office of Sidley Austin. It is my pleasure to appear before you today to discuss the evolution of the credit card industry, and the revisions to Regulation Z recently proposed by the Board of Governors of the Federal Reserve System.

Congress enacted the Truth in Lending Act, or TILA, almost 40 years ago to provide consumer protection in the developing consumer credit marketplace. The Board has regulatory authority to implement TILA through its Regulation Z. Regulation Z requires comprehensive cost disclosures for consumers so they can shop for credit, which facilitates competition among creditors.

Standardized disclosure, under Regulation Z, fosters competition among credit card issuers on the basis of key account terms, such as interest rates and fees. Competition based on these disclosures is especially effective in the credit card industry, because there is wide availability of credit card offerings and balance transfer fea-

tures, allowing consumers to move easily from one card issuer to another.

The credit card industry has evolved significantly over the years, including through the development of risk-based pricing, and debundling of prices. However, Regulation Z's basic methods of protecting consumers can be just as effective today as when Regulation Z was first enacted. The key is to update and improve Regulation Z disclosures to ensure that consumers can shop effectively for credit cards in today's marketplace.

As you know, the Board recently released significant proposed revisions to Regulation Z. The Board's proposal is a major undertaking to increase the understandability and usefulness of Regulation Z disclosures. Although it is likely that both industry and consumer groups will seek many changes to the proposal, I believe there is a consensus that credit card disclosures need to be improved. I also believe the proposal is, generally, a major step in the right direction.

I think it is critically important that, for the most part, the proposal avoids price controls and similar restrictions. Price controls seldom work, and it would be far preferable to allow the fierce competition in the marketplace to drive the future developments of credit card products.

Significantly, the Board's proposal is based on actual consumer testing. The Board has attempted to determine what consumers want to see in disclosures, and not necessarily what consumer groups, the industry, or the Board itself might assume consumers want.

The Board's proposal contains very significant changes. Broadly speaking, the Board proposes: number one, to improve and increase disclosures relating to newer pricing methods, including penalty pricing; number two, to expand the use of standardized charts to facilitate easy and quick review of credit terms; and number three, to use terminology that consumers understand, such as "interest rates and fees," instead of legal terms that have little meaning to consumers.

The Board's proposal also would adopt a significant substantive protection to facilitate the ability of consumers to move credit card balances to a new creditor, because of an interest rate increase. In particular, Regulation Z would expand the advance notice period for interest rate increases from 15 to 45 days, and, for the first time, apply that longer notice period before penalty interest rates can be imposed.

These changes are designed to better allow a consumer to shop for a new credit card, and transfer an existing balance to a new creditor, if the consumer qualifies for a better rate.

As I mentioned, I believe the Board may need to consider some changes to its proposal. Some of the items included in the proposal appear at first blush to impose significant costs on the industry, without providing counterbalancing benefits to consumers. The net result may be increased credit costs to consumers without appreciable consumer benefits.

For example, the expectation that certain disclosures would be provided on long, legal-sized paper may be a costly proposition. Furthermore, the proposal to completely redesign periodic state-

ments will cause substantial resources to be allocated by card issuers, which may or may not be justified, in light of the fact that periodic statements have not tended to be confusing for consumers.

In conclusion, I believe that the underlying approach of TILA to consumer protection for credit cards is just as effective today as when Regulation Z was originally adopted. Given the significant competition in the credit card marketplace, a well-informed consumer has, literally, dozens of options when choosing a credit card. The Board has done an admirable job in proposing necessary changes to Regulation Z, to ensure that consumers do, in fact, receive information they need to shop effectively in today's credit card marketplace. Thank you again, Chairwoman Maloney, for the opportunity to appear before the subcommittee. I would be happy to answer any questions you may have.

[The prepared statement of Mr. Huizinga can be found on page 181 of the appendix.]

STATEMENT OF JOHN P. CAREY, CHIEF ADMINISTRATIVE OFFICER, CITI CARDS

Mr. CAREY. Good afternoon, Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee. My name is John Carey, and I am the chief administrative officer of Citi Cards. I appreciate the opportunity to appear before you today to discuss the credit card business, and how we serve our customers.

Citi Cards is one of the leading providers of credit cards in the United States, employing 33,000 people in 28 locations across 20 States. Credit cards have become an integral part of our Nation's economy, providing meaningful benefits to merchants and consumers alike. Merchants enjoy the prompt payment, security, and efficiency of credit cards. For consumers, credit cards are a safe and convenient alternative to cash, making everyday purchases more efficient, making online shopping possible, and helping them track and manage their spending.

I understand that the subcommittee's primary focus today is on the initiatives in the credit card industry that affect consumers, including the Federal Reserve Board's new proposed revision to Regulation Z. Let me turn to the Fed's proposal first, and then describe what we have been doing at Citi in recent years, including new initiatives implemented to improve our customers' experience.

Two weeks ago, the Fed issued a comprehensive proposal to revise Reg Z, focusing on disclosure and other practices. This lengthy proposal will, of course, require a detailed study. But let me state in no uncertain terms that we applaud what the Fed has done, and believe it can foster significant improvements for consumers.

The new proposal is aimed at enhancing the clarity of disclosures, improving customer understanding of key credit card terms and conditions, and maximizing transparency. In effect, the proposed changes seek to move credit card disclosures towards the successful model of food labeling, where consumers can get all the information they need in simple, uniform terms, that allow them to readily compare one product to another.

Consumers should be able to do this in the credit card world, relying on consistent presentation of important information when applying for credit, when opening an account, when receiving their

statement, and when the terms of the account change. This is the right approach, and we strongly support it.

Our own efforts to make credit card disclosures clear and understandable are entirely consistent with the approach taken by the Fed. Indeed, all of the effective and simpler-to-read disclosures cited by the GAO in its September 2006 report on credit cards were Citi disclosures. Our work in this area intensified in 2005, following a public call from the OCC for improved credit card disclosures, and has continued right to the present.

Citi was one of the first card issuers to revise its solicitation letters, promotional materials, and card member agreements, to more prominently disclose the important pricing terms in the product. Today we are continuing to improve and simplify our Schumer Box, and implement major redesign of our customer statements.

In short, we want consumers to understand clearly what we are offering and what our competitors are offering, so that they can make informed choices. We are confident that we can compete on quality, service, and value, and that it will be good for customers and good for Citi.

But improving disclosures isn't the end of the discussion. Citi has also recently adopted two major initiatives that represent a change in the industry, and that we hope other issuers will adopt, as well.

First, Citi was among the first issuers to eliminate repricing for what we call off-us credit behavior. Not just automatic repricing, known by some as universal default, but any repricing.

Second, we eliminated what is commonly known as any-time, any-reason increases to the rates and fees of our customers' accounts, for example, to respond to general market conditions or credit history. Once a card is issued, we will not voluntarily increase the rates or fees on the account until the card expires and a new card is issued, which is generally 2 years.

Further, to assist customers to pay on time and avoid exceeding their credit limit, we have established an alert system with consumers that they can tailor to meet their individual needs to notify them in advance about key dates and information related to their bills.

Moreover, Citi is an industry leader in financial education and literacy, and we have put in place numerous programs to encourage and promote responsible borrowing.

Finally, we are also a leader in protecting our consumers from identity theft and fraud, and in offering immediate, effective help, regardless of the card which was affected by this identity theft.

Madam Chairwoman, we are working on a daily basis to enhance the products and services we offer our customers. This job is never finished. We know that there is always room for improvement. I look forward to answering any questions that you or the subcommittee may have.

[The prepared statement of Mr. Carey can be found on page 108 of the appendix.]

STATEMENT OF WILLIAM CAYWOOD, SENIOR CONSUMER CREDIT RISK AND COMPLIANCE OFFICER, BANK OF AMERICA

Mr. CAYWOOD. Thank you. Good afternoon, Chairwoman Maloney, Ranking Member Gillmor, and members of the sub-

committee. My name is Bill Caywood, and I am the operational risk and compliance officer for Bank of America, with a scope that includes credit cards. The committee has asked us for our views on the Federal Reserve Board's proposal to substantially revise its Regulation Z.

As you have heard today, the job of describing how the credit card works has become complex. Certainly, card agreements were simpler when the product was offered only to wealthier customers who paid an annual fee, and were required to repay the balance in full each month. But the current system has expanded access to credit, and made the credit card a more useful instrument for more consumers than ever before.

Our initial review of the new Reg Z suggests that the proposed revisions are an improvement on the existing regulation. It will provide customers meaningful disclosures in an even clearer format, and it will facilitate comparison shopping, and better allow consumers to modify their behavior, potentially reducing their cost of credit.

In its proposal, the Board has amended several of the required disclosures to provide a useful tabular summary. Furthermore, transactions, interest charges, and fees will be grouped together in a new way that we think will be more easily understood by customers. We believe that the revised statement will quickly and more clearly provide customers relevant information about their accounts, and assist them to better understand the cause of any credit-related fees incurred during the previous cycle.

While our overall reaction to the proposal is favorable, the proposed changes to Reg Z would require issuers to expend considerable time and resources to rewrite the vast majority of our communications with our customers, and to change the ways that these communications are delivered. It would also require substantial time to prepare and test, and it will be important for the Board to allow sufficient time for that to occur.

We have also identified one area in the proposal described in my written testimony, where we believe it can be improved. Our review between now and October, when the comment period ends, may identify others, and we will include those in a comprehensive comment to the Board.

Some specific credit card practices have been the focus of recent criticism and discussion here today. We believe it is important to reiterate Bank of America's position on these issues.

Bank of America has never engaged in double-cycle billing.

Bank of America has never engaged in universal default. That is, automatically repricing a customer, without further notice or consent, based only on the customer's default with another lender.

Bank of America limits the frequency of risk-based repricing by amendment. In addition, when we determine that an account's risk has increased, and propose an increased interest rate, the customer can opt out of the proposed change in terms and pay down the account over time under the existing terms. We call this, "Just Say No."

Bank of America limits the number of consecutive over-limit fees. We have a hard stop at three.

I am proud to say that we arrived at these policies some time ago, by listening to our customers, and implementing practices designed to meet their financial needs and concerns. More recently, we have modified our default repricing, to be based on two events: late payments or overlimit transactions.

We think it is fair to give customers a second chance. And when customers with increased rates pay us on time for 6 months, and stay within their credit limit, they can qualify for a rate reduction, or a "cure."

It was also from listening to our customers that we learned that they have a growing desire for improved information and more control over their finances. This is why we offer easy-to-use tools to help our customers manage their accounts responsibly. Online banking allows customers to view information about their credit card and other accounts. Customers can track activity, transfer funds, and pay bills any time, anywhere they have Internet access.

Alerts are messages that we send to computers, PDAs, or mobile phones to inform or protect our customers. They can warn a customer when he or she is approaching a credit limit, or has an upcoming payment due date. Our alerts go by e-mail or text message, or both. Customers love this option. We have more than 1.3 million enrolled to receive alerts already.

We have also gone beyond the required disclosures to provide customers with brochures that describe, in plain language, how credit cards work, and how to avoid fees. One example is called, "Credit Cards and You," which I have a copy of here, which provides clear information about interest rates, grace periods, and how cash advances and balance transfers are treated, how payments are allocated among outstanding balances, and the importance of paying on time and staying within your credit limit.

In addition, Bank of America believes that financial literacy is best taught early. That is why we sponsor basic money management programs for high school and college students with our partner, Monster.com. Between August 2006 and March 2007, we made nearly 240 presentations to more than 13,000 students on college campuses.

Why are we engaged in these financial education efforts? Our research shows that customers who are empowered with this information are more satisfied and more likely to look to us for a deposit or mortgage account.

Second, our business does best when our customers manage their credit responsibly. One of the great myths that we hear is that credit card companies prefer customers to default on their obligation, so that we can earn higher fees. That's simply not the case. Our credit losses exceed by a wide margin our revenue from late and overlimit fees. We want informed customers, and that is why we have not only undertaken our own efforts to educate them, but we support the efforts of the Board.

In conclusion, thank you for this opportunity to address the subcommittee, and I would be happy to respond to any questions the members may have.

[The prepared statement of Mr. Caywood can be found on page 123 of the appendix.]

STATEMENT OF JOHN G. FINNERAN, JR., GENERAL COUNSEL, CAPITAL ONE

Mr. FINNERAN. Good afternoon Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee. My name is John Finneran, and I am the general counsel of Capital One Financial Corporation. I want to thank you for this opportunity to address the subcommittee this afternoon.

Today the credit card is among the most popular forms of payment in America. It is valued by consumers and merchants alike for its convenience, efficiency, and security. But credit cards have also become more complex, with a variety of benefits and terms. The current disclosure regime under the Truth in Lending Act, as implemented by Regulation Z, did not contemplate this complexity.

As well as meeting the current requirements of Reg Z, in recent years, Capital One has implemented a dynamic disclosure regime, focused on simple and timely communication of critical information to our customers, as well as our prospective customers.

We at Capital One want to join those who have praised the Federal Reserve Board for the depth and thoroughness of its proposed changes to Reg Z. Capital One commented in advance of the rule with its own recommendations for comprehensive change, and were pleased to find in this proposal by the Fed new rules that incorporate many of our recommendations.

For years, Capital One has been focused on two critical priorities which we believe to be integral to the empowerment of our customers, and the health of our industry—good disclosure and default repricing practice. Although we haven't had the time to assess the full implications of the Fed's proposal, we believe that the Board is focused appropriately on these issues, as well.

The Fed's proposal, if adopted, would transform the basic concept of disclosure, altogether. It would move to a targeted regime of plain English notices that are delivered to customers at the moment when they are most relevant to them. We strongly support the Board's proposal in this regard.

As importantly, the Federal Reserve's proposal has identified what Capital One believes to be the most challenging practice in the industry today, and that is aggressive default repricing. Requiring card issuers to notify customers 45 days prior to default repricing is a bold proposal. Capital One has already addressed this issue in a different way, with a single, simple default repricing policy that provides our customers with a warning before we will consider taking any action.

Our policy is simple: Capital One will not default reprice any customer unless they pay 3 or more days late twice in a 12-month period. After the first infraction, customers are provided with a prominent statement on their monthly bill, alerting them that they may be default repriced if they pay late again.

Furthermore, the decision to default reprice someone is not automatic. For many customers, Capital One chooses not to do so. If we do default reprice someone after being late twice, we will let them earn back their prior rate by paying us on time for 12 consecutive months. This process of unrepricing is automatic.

To be clear, Capital One does not practice any form of universal default. That has been our long-standing policy. We will not reprice

a customer if they pay late on another account with us or any other lender, or because their credit score goes down for any reason. In addition, Capital One will not reprice customers if they go over their credit limit or bounce a check.

While the Federal Reserve offers a different approach, we share the same goal, ensuring the customers receive a warning before they're repriced, and an opportunity to learn about the potential consequences of their behavior before they are repriced in any manner. We hope the Federal Reserve will consider the merits of our current approach, and determine whether some additional flexibility in the final rule is warranted.

Although the optimal means of eliminating aggressive default repricing may be the subject of some debate this afternoon, Capital One recommends that the Federal Reserve go one step further. Issuers should be required to tell customers the exact type of infraction that caused the change in their interest rates.

Today, when a customer is repriced for breaking a contractual rule, such as paying late, going over the limit, or defaulting on another account, the issuer is under no obligation to explain why. We believe that disclosing the infraction that caused the repricing will create a teachable moment, and will enable customers to gain the full benefits of greater transparency.

As issuers, however, we have an obligation to ensure the customers not only understand the products we offer, but that our practices meet the standards of reasonableness and fairness our customers expect.

Consistent with the Board's proposal, Capital One has adopted strict policies regarding the marketing and treatment of fixed rates. Our fixed rates are not subject to any form of repricing during the specific period for which they are promised. In addition, Capital One has never engaged in double-cycle billing.

The overwhelming majority of Capital One's customers use their accounts responsibly, and enjoy the many benefits this form of payment offers. Capital One looks for early indications, however, that a particular customer may be experiencing challenges. For example, any customer who pays us only the minimum for three consecutive months receives a notice on their statement that emphasizes the consequences of this practice, and encourages them to pay down their balance more quickly.

While we support the Federal Reserve's efforts to provide more information in this regard, we believe that our current approach, providing notice only to those who actually routinely pay the minimum, enhances the relevancy of the disclosure, and better advances the Federal Reserve's stated objective of developing more targeted and dynamic disclosure regime.

In conclusion, we believe that the Federal Reserve's proposal represents an important step forward for consumers and our industry. At Capital One, however, we do not view it as a substitute for continuously adapting our practices and policies to keep up with consumer demand, the rigors of competition, and the standards of sound banking. I thank you, and I look forward to answering your questions.

[The prepared statement of Mr. Finneran can be found on page 175 of the appendix.]

STATEMENT OF MARILYN LANDIS, BASIC BUSINESS CONCEPTS, INC., PITTSBURGH, PA, ON BEHALF OF THE NATIONAL SMALL BUSINESS ASSOCIATION

Ms. LANDIS. Congresswoman Maloney, and Ranking Member Gillmor, thank you for inviting me here today to discuss the impact that various credit card practices are having on America's small business community.

My name is Marilyn Landis, and I am representing the National Small Business Association. I am also the owner of Basic Business Concepts, a consulting and financial management company serving small businesses. Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks, and small businesses throughout western Pennsylvania.

Access to capital is one of the largest obstacles facing America's small businesses. Many small and start-up businesses lack the assets necessary for traditional bank loans. Ongoing bank consolidation has resulted in fewer community banks and fewer character-based loans. Into this access-to-capital vacuum, a new capital issue has sprung to the forefront, an increased reliance on credit cards.

Rapidly growing businesses that are not traditional brick and mortar like mine have neither equity and hard assets, nor historic cash flow to support their loan requests. We are forced to use bank credit lines which, if not secured with equity in our home, are increasingly credit card accounts. These businesses do not want to rely on credit card debt; they are forced to.

According to a nationwide survey of small and mid-sized small business owners recently commissioned by NSBA, credit cards are a primary source of financing for America's small businesses. In fact, 44 percent of small business owners identified credit cards as a source of financing that their company had used in the prior 12 months, more than any other source of financing.

In 1993, only 16 percent of small business owners identified credit cards as a source of funding they had used in the prior 12 months. Of the small business owners who use credit cards as a source of funding, 71 percent report carrying a balance month to month, and 36 percent are carrying a balance of more than $10,000.

It is important to note that small business owners are not turning to credit cards to finance their businesses because they think they are getting a good deal. In fact, among those using credit cards, 53 percent say that the terms of their credit have gotten worse over the last 5 years.

Why should the small business community's increased reliance on credit cards and their sense of worsening credit terms be of interest to this subcommittee? Put simply, small businesses are the engine of the U.S. economy, and the backbone of the communities you represent.

The billions of dollars in retroactive interest rate hikes, escalating and possession of undisclosed fees, and unilateral and unforeseen interest rate increases is money diverted from economic development. A third of small and mid-sized businesses say that they would hire additional employees if more capital were available.

In order to address the practices that make running a small business increasingly difficult, and hinder the economic development of the Nation's small businesses, NSBA supports credit card reform.

NSBA supports the enactment of the new credit card regulations recently proposed by the Federal Reserve, improved disclosure, which must not be construed as simply more disclosure, is of paramount importance to the small business community. We are business people, more than capable of playing by the rules. But the rules must be made known, and they must be consistent and predictable.

Let me detail a personal incident that demonstrates the inconsistent and unpredictable nature of current credit card practices. I have an Advanta credit card, for which I carry an average daily balance of around $5,000, at 2.99 percent. In November of 2006, I took a cash advance, paid the fee, paid the interest on the fee, and secured an additional $14,000 at 11.4 percent. There was no activity for the next month, and I made my payment on time.

Therefore, the following month, I was surprised to see my cash advance interest rate had gone from 11.49 to 20.01 percent. Equally surprising was that my average daily balance, which I was paying previously 2.9 percent, had dropped by about $4,000, while the rest of my outstanding balance, which was now at 19.99, had jumped by that $4,000, with no explanation.

One can imagine how difficult it is to adhere to a business plan with this sort of unpredictability lurking in an expenditure. My Bank of America card, on the other hand, had an interesting payment feature. The due dates have never stayed the same, fluctuating by 5 days in the last 7 months, and the statement cut-off date has stayed the same.

The same can be true of my MBNA card, which was purchased by Bank of America. Previously, the due date was the 27th. But between December of 2006, and April of 2007, the due dates for the card have fluctuated greatly. Again, the statement date has stayed the same. It is this unpredictability that makes it very difficult to plan.

While Regulation Z and the Truth in Lending Act requires that affected card holders should be notified in writing of any proposed change in rates at terms of 15 days before change, the Federal Reserve proposed increasing this notification to 45 days. This opt-out option does little to help small businesses who are carrying large month-to-month balances. Most small business owners are forced to use credit cards to finance a capital expenditure or an expansion of their business.

Further, as exorbitant as the penalty rates most credit card issuers may appear, the small business members of NSBA do not advocate a cap on rates. NSBA does support eliminating the retroactive application of penalty rates. This effectively increases the purchase price of the goods.

In conclusion, America's small business community is not opposed to the credit card industry, nor is it in the habit of advocating the passage of increased Federal regulation, preferring free enterprise and market solutions. NSBA strongly encourages both the Administration and Congress to fully support small businesses as a true center of growth in the U.S. economy, and take the lead

in ensuring credit card practices are not restricting small business growth.

I thank you for your time, and welcome any questions.

[The prepared statement of Ms. Landis can be found on page 226 of the appendix.]

Chairwoman MALONEY. Mr. Mierzwinski?

STATEMENT OF EDMUND MIERZWINSKI, CONSUMER PROGRAM DIRECTOR, UNITED STATES PUBLIC INTEREST RESEARCH GROUP

Mr. MIERZWINSKI. Thank you, Chairwoman Maloney, Ranking Member Gillmor, and members of the committee. I am Ed Mierzwinski, and on behalf of the State Public Interest Research Groups, I appreciate the opportunity to testify before the committee.

Owning a credit card company is a license to steal. You can change the rules at any time, for any reason, including no reason, and you are allowed to operate nationwide, from any State that forms a safe harbor for you. We believe, as a consumer advocacy organization, that the Federal Reserve disclosure proposals are a first small step toward reform of this industry.

If you look at this industry, and you look at the marketplace, you say, "How do we ensure that a marketplace is disciplined?" First, there must be competition. Well, in competition, we have a number of rules for competition. One of those rules is that you have to have a lot of players and easy entry. We have a tight oligopoly in this industry. The top 10 players dominate the industry.

Second, consumers don't have adequate information. They don't have the ability to make choices. Their contract can be changed at any time, they have no opportunity to fix their contract. It's a one-sided contract of adhesion. And many of the terms in it are too complex, even for financial literacy classes, which we support to improve.

The problem is, you have a choice of law terms, you have these various contractual complexities, you have the ability to calculate interest in four or five different legal ways. It is impossible to address the problems.

So, second, if you don't have a marketplace that is competitive, you have regulation. What kinds of regulation do you have? I would say there are three levels of regulation.

First, there is private enforcement. There is virtually no ability of private consumers to police this marketplace, due to mandatory arbitration clauses that limit their ability to go to court. We need to get rid of the mandatory arbitration clauses that restrict consumers' ability to privately enforce their credit card contracts.

The second level of protection is State enforcers. As you have heard, and as you will be hearing next week, we will discuss the State enforcers have been defanged by the OCC pre-emption rules. Because the OCC regulates 9 of the 10 largest credit card companies, it effectively is the de facto policer of the entire industry.

As this committee pointed out in a bipartisan vote several years ago, the OCC is inadequate, in terms of its enforcement ability, and its number of enforcers, its number of consumer complaint handlers to protect consumers against the industry.

As we also know, neither the OCC, nor the Fed, which regulates the other large issuers, has taken any formal enforcement action against any of the large issuers in the last 5 years or so. That does not send a clear message that we are on top of our game.

So, when you have no private enforcement, when you have a defanging of the State enforcers, and when you have the Federal enforcers asleep at the switch, asleep at the wheel, you have a system that is out of control. That's where all these unfair practices are coming from.

Now, your questions earlier, Madam Chairwoman, I commend you for your questions to the Federal Reserve. The consumer groups, in our comments to the Fed, the joint comments that the NCLC, Center for Responsible Lending, CFA, Consumers Union and others provided, we said the Fed should go further than disclosure changes. Let me just make one point that gets to some of the questions that Mr. Cleaver and others were asking.

We believe that the Fed has the authority to order the banks to do exactly what the IRS has as its rule. If a bill is postmarked on the date due, the bill is timely. Why doesn't the Fed go further, and do that?

We believe that the problems of this industry, where you are making just incredible amounts of money, but you want to make more money so you come up with unfair fees, the second way you make more money—the problem with this industry are now reaching out to new populations. And I got into details on this in my testimony.

I would commend to you a report that I cite from the National Council of La Raza on the problems Latino customers are facing with credit card issues. And I would also point out that the programs founded on college campuses were very concerned about the aggressive marketing on campuses, where you get trinkets, frisbees, or bottles of soda in return for filling out credit applications.

We have set up our own counter-programming on campus, where we hand out anti-credit card company marketing brochures. So, this one is the, "Charge it to the Max Credit Card." In return for filling out the credit card application, we will give you a free skateboard key ring. I'm not exactly sure what a free skateboard key ring is, but in terms of the kinds of junk that they're handing out on campus, we are very concerned about it.

In our testimony, we outline a number of the bills which we would support, and other consumer groups would support. Most of the provisions in them have been articulated in the members' questions.

So, again, I appreciate the opportunity to testify before you today, and I encourage you to remember that the real solution is not disclosure. The solution is to ban the unfair practices, to reinstate the authority of State enforcers, and to give consumers a right to enforce the laws themselves, by eliminating mandatory arbitration clauses in credit card contracts.

[The prepared statement of Mr. Mierzwinski can be found on page 233 of the appendix.]

Chairwoman MALONEY. Thank you. First, I will call on my colleague, Mr. Gillmor.

Mr. GILLMOR. Thank you very much, Madam Chairwoman. First, I will call on Mr. Huizinga. I want to ask you a question about profitability in the industry.

Going back over the last, say, 10 or 15 years, what is the level of profitability now, compared to then? And the other—as part of that question, there has been some thought that while interest rates may have come down, fee income has gone up.

So, two questions. One, what is your overall level of profitability over that period of time? And what is the component of that profitability, in terms of interest versus fees?

Mr. HUIZINGA. The GAO did a comprehensive study of the credit card industry, and released their report last October; I think they addressed those issues in their report. I believe that GAO found the profitability of the major credit card issuers has remained relatively constant over the last 5- to 10-year period.

What has changed—which I think leads to your second question—is the method by which credit cards have been priced. We can all remember, many years ago, when all credit cards essentially had an annual fee and a 20 percent interest rate. And what has evolved over the last several years has been more individualized, tailored pricing, many times referred to as risk-based pricing, where more favorable rates are offered to consumers with better credit records, and higher interest rates are typically charged to those with less favorable credit records.

There also has been a de-bundling of prices, which I think I alluded to briefly in my testimony, where there are more fees that are imposed for particular services that consumers may want.

So, I think that in terms of the overall pricing, what we have seen is more of a change in the method of pricing and allocation of pricing, as opposed to increases in pricing. In fact, I think what the GAO study found was that, overall, many consumers have benefitted from the more tailored pricing models.

Mr. GILLMOR. Yes, but the question was, what's the mix? I mean, if it was 90 percent interest/10 percent fees 15 years ago, is it 50/50 now? Or is there data on that?

Mr. HUIZINGA. I am not sure about the actual mix.

Mr. GILLMOR. Yes.

Mr. HUIZINGA. There has been an increase in the fees. I think the Fed has addressed that, and we are seeing—I think we mentioned earlier the fact that Regulation Z is being updated, if you will.

And I think one of the things that the regulation does is take account of that. In the proposal, there is an increased emphasis on disclosure of fees. That's both in the tables, as well as, importantly, on the periodic statement. When those fees are actually imposed, the Fed has greatly improved the disclosures, so the consumers will understand the fees that are being charged.

Mr. GILLMOR. Let me go to Mr. Mierzwinski. You talked in your written testimony about the fine print. I think we all agree there is lots of fine print there, nobody reads it, nobody understands it.

But we have a problem here of coming up with some kind of balance. I mean, a lot of that fine print is there because the government requires it, and the regulators say you have to do it. So, I guess, what is your answer to how we find the balance of what has

to be disclosed, and how you get it distilled in a form that people will read and will understand?

Mr. MIERZWINSKI. Well, thank you, Mr. Gillmor. The fine print, or the mice type, as I sometimes call it, is a significant problem. And the fact that it can change at any time is an additional problem.

We are still examining the Fed's proposals. The fact is that there can be some important disclosures that are made in bigger print, and that are the required disclosures, but the real problem is that they are allowed to charge as many fees as they want, they can use four different methods of balance calculation—

Mr. GILLMOR. Yes, but that is not—

Mr. MIERZWINSKI. They can reach back—

Mr. GILLMOR. I understand. That is not responsive to my—

Mr. MIERZWINSKI. Well, what is responsive is—

Mr. GILLMOR.—to the question.

Mr. MIERZWINSKI. I would be happy to get back to you in detail in writing, then, Mr. Gillmor, with some ideas. But, obviously, we want to calculate the true cost of credit as accurately as possible. We don't think the Fed's rules will do all of it.

Mr. GILLMOR. Okay. No, I appreciate that. But one of the concerns—this isn't necessarily directed at you at all—but one of the concerns I have is that a lot of us in government, we complain about fine print, and then we introduce bills that require more fine print. And so that's a problem I think we have to deal with.

Chairwoman MALONEY. Mr. Gillmor?

Mr. GILLMOR. I yield back.

Chairwoman MALONEY. Thank you. I would like to ask unanimous consent to place into the record two documents: First, a letter that the National Association of Federal Credit Unions sent to the members of the subcommittee; and second, testimony from the New York State Consumer Protection Board. Without objection, these documents will be made part of the official record.

We have been called for a series of votes. So in the interest of time, I would like to ask the panelists to get back to me and the committee members in writing what you would recommend for best practices for reforming the system.

And I now yield to my colleague from the great State of New York, Gary Ackerman.

Mr. ACKERMAN. I thank the chairwoman. I had a meeting scheduled during this time, but I was trying to arrange a meeting with Mr. Carey afterwards, so that I could ask him a question and not have to do it here, at the committee, about a practice that Citibank—I thought perhaps we could do it in my office, but you didn't seem to have time, so I came back down and rescheduled my other meeting.

Here is the question. We just found a new first, I think. My chief of staff on another committee went home the other day, and got a notice from Citibank. He and his wife are customers, and they have, I believe, a Visa card, which they are content with. They got a notice about a new product that Citi was offering, which was an American Express card. And for their reasons, whatever they were, they weren't interested, and they threw the notice away. This was a short while ago.

Yesterday, they got a notice from Citibank, thanking them for changing from the credit card that they had, which was a Visa card, to an American Express card that they didn't want. They didn't say they wanted it; they threw it away.

So, after getting stuck in voicemail hell for a while, they got a real person, and after a protracted period of time, were able to explain to them that they didn't want it, they didn't order it. And it was explained to them that somewhere in the language of whatever it was that Citibank—embarrassingly, in my opinion—sent them, it said somewhere that, "If you don't respond to us, we are switching your credit card," so that no response became the response that triggered them getting a new credit card, which they don't want.

After a while, they got it straightened out. But I would venture to guess that more people—and the older you are, the more predisposed you are of doing this—don't read all those things, and don't bother to change it. And suddenly, the product that they did know about, that they ordered, that they were happy with, gets changed.

Don't you think that it is unfair, if you get no response, to take an affirmative action, and assume that somebody wants to make a change, when most people think that if they throw something away, they're with the status quo?

Shouldn't they have to affirmatively respond, rather than just taking the—what I assume to be the majority of people, who don't know what's happening to them, and just switching their credit cards with different terms and conditions?

Mr. CAREY. Congressman, I think your point is a very good point. I can certainly take that back to my business area, and we can review that. I understand the concern. I would say that the card that was offered was certainly equivalent, if not better, than the card that they had previously, and—

Mr. ACKERMAN. I am not arguing. I have both.

Mr. CAREY. Okay.

Mr. ACKERMAN. So I am—you know, I have no personal dog in that fight. But people are entitled to make decisions, and not have somebody swap—making the decisions.

If we are in favor of people making their own choices based on information, then that choice shouldn't be taken away from them.

Mr. CAREY. You are absolutely correct. I agree with that.

Mr. ACKERMAN. I do have some other issues, but I will—hopefully, we can talk about them when you have the opportunity to meet.

Mr. CAREY. I look forward to it.

Mr. ACKERMAN. I yield back the balance of my time.

Chairwoman MALONEY. We are going to adjourn for 10 minutes for votes. Thank you. And we will be coming back.

[Recess]

Chairwoman MALONEY. The meeting will be called to order. Congressman Gillmor suggested that I begin without him, as he has a conflict, but he will try to get back.

And I now recognize Congresswoman Bean, from the great State of Illinois.

Ms. BEAN. Thank you, Madam Chairwoman. I wanted to direct my question to Mr. Carey regarding what someone with the Federal Reserve has proposed, on the reworking of Reg Z.

I know in your testimony, and I believe some of the other testimonies, there was discussion of how repricing practices could change, particularly if the 45-day notice period is implemented. What type of changes would you anticipate?

Mr. CAREY. The Fed's rule around the 45 days, I think, is centered around the concept that when customers apply for credit, they have an expectation that the rate that they applied for is something that they can rely on. And what the Fed has done with their 45-day rule is that they have, I think, provided some level of reliance for that.

Now, what we have done at Citi is a little bit different from how the Fed has approached this. We have abandoned the practice of any-time, any-reason. So, if your credit behavior changes with other creditors, or if market conditions change, we would not change your rate for the life of the credit card, which is approximately 2 years, because we think it centers on the proposal that, "Look, this is what I applied for, this is what my terms are, and in essence, a deal is a deal."

So, that is the approach we have taken. I think the Fed is on the right track with it. And we—you know, there are pieces of it we have to look at, but we generally think that this is the right approach towards dealing with most repricing issues.

Ms. BEAN. Okay. And the other question I would ask you—and there might be other panelists who may wish to respond, as well—is, clearly, looking back over the years where there was more average rates that were charged, and now there is more risk-based pricing, but also providing credit to a lot more folks in the process, if the industry moves far away from risk-based pricing, is there then the risk that overall rates go up for the broader pool of credit card holders to cover those where we might lose practices that charge those who have worsening credit ratings, so that the whole pool of credit card holders aren't hit?

Will that spread it, and is there also risk that average rates go up for the broader pool?

Mr. CAREY. I think that is a terrific question. You know, if you go back and look at the industry, the average credit card rates of 15 or 20 years ago were around 19 percent, on average, and it really didn't matter whether you were high risk or not. Everybody got the same price.

Ms. BEAN. Same rate.

Mr. CAREY. And what has happened over time is that the rates in the industry have gone down. Overall, they have gone down. And so, the people who have the best credit record in a risk-based credit system get the best pricing, and those who are higher risk pay a higher price for the credit.

But what has also happened is that there is more access. People who would not have qualified for a credit card 20 years ago, now have an opportunity to apply for a credit card, and be approved for credit, and be able to use a credit card.

So, we think that pricing would go up, and that the availability of the product would not—

Ms. BEAN. Go down.

Mr. CAREY. No, be as universal as it is now.

Ms. BEAN. Any other panelists, if I have time, who wish to comment on that?

Mr. MIERZWINSKI. If I may?

Ms. BEAN. Yes.

Mr. MIERZWINSKI. Very briefly, Congresswoman, I would simply say that we would be happy to try to provide you with more information, which I don't have in my written testimony, about one of the reasons that the cost of credit has declined—and a point that I don't think has been made—is that the bank's cost of money declined dramatically over that period, as well.

And second, we would point out that the use of risk-based pricing is something that the consumer groups don't necessarily directly oppose, but we do oppose using it as a cover for unfair practices. When they claim that, "Oh, we had to do this because of risk-based pricing," well, obviously, now that everybody is stopping doing certain things, we think it really wasn't risk-based pricing.

Ms. BEAN. That is similar to recent hearings we have done in the broader committee on the subprime lending market. We don't want to discourage liquidity and access to mortgages to people with less than perfect credit. We certainly want that availability. But we don't want to go so overboard that we charge everybody for those who are in a higher risk pool, yes.

That is all I have. I yield back.

Chairwoman MALONEY. The Chair recognizes Mr. Ellison.

Mr. ELLISON. Yes, I would like to follow up on this question of the price of money over the last 30 years. I think in 1979 we had high inflation and high interest rates.

But I mean, the Fed engages in monetary policy, and they pursued the monetary policy that brought interest rates down. Isn't that correct, as a matter of American monetary policy? This is not a function of the credit card industry.

Mr. CAREY. It really depends upon the period of time which you are speaking about. I am talking about a period of time between 1995 and today.

Mr. ELLISON. Okay.

Mr. CAREY. And, again, I would have to go back and look at the cost of funds. But my understanding is that the cost of funds wasn't substantially different than it is today.

Mr. ELLISON. Any thoughts on that, Mr. Mierzwinski?

Mr. MIERZWINSKI. My recollection is that the Fed lowered rates to historically low rates in the early part of this century, and rates for auto loans, rates for home loans, all kinds of rates declined to very low levels, as everyone knows, but credit card rates did not decline as much.

Mr. ELLISON. I would also like to ask some questions about risk-based pricing. Could you help me understand? Risk-based pricing is, I guess, a pricing scheme that ties the price of money to—or access to it—to the amount of risk associated with loaning that money.

And if risk-based pricing is actually how the credit card companies do pricing, how could a congressional hearing shining light on things like double-cycle billing, universal default, how could just a

congressional hearing actually get those sort of practices to be dispensed with voluntarily by the company? You understand my point? Maybe you don't. Mr. Caywood?

Mr. CAYWOOD. I understand your point, and I would just say, on behalf of Bank of America, that didn't happen.

Mr. ELLISON. Okay.

Mr. CAYWOOD. That we did not engage in universal default, or double-cycle billing well, well before any of the hearings began.

Mr. ELLISON. Right.

Mr. CAYWOOD. So, because we listened to our customers, and decided those were not practices we would engage in.

Mr. ELLISON. And, Mr. Caywood, I think you are making my point, exactly. If somebody says we have to do these things because of the risk, then how do you explain what Citigroup, Bank of America, and some of the—and I think half of the top 10 have voluntarily dispensed with the practice?

So, it seems to me that the practices of double-cycle billing and universal default cannot be rationally tied to risk-based pricing. Am I right or wrong?

Mr. CAYWOOD. I think those practices are different than risk-based pricing.

Mr. ELLISON. Right, you're right. They are different, but don't they, in fact, reflect the idea that these—that some of these credit card holders actually are—I mean, that these practices can be justified by greater risk? Because credit cards are a higher risk form of money. So they're justified by saying, "Well, they are higher risk, so we can do these things." Am I right about that?

Mr. CAYWOOD. I think there are ways to do risk-based pricing without engaging in universal default.

Mr. ELLISON. Yes.

Mr. CAYWOOD. But—

Mr. ELLISON. And I think you and I agree on that, but I guess I am curious to know the other side of the coin. For companies that do it, how do they justify doing it? Do they justify it because credit cards are riskier?

Mr. CAYWOOD. I don't—

Mr. ELLISON. You don't do it that—

Mr. CAYWOOD. No, we don't. Sorry.

Mr. ELLISON. Mr. Mierzwinski, do you have any thoughts on it?

Mr. MIERZWINSKI. I do, but Kathleen, I think, has some points.

Mr. ELLISON. Oh, I didn't see. Sorry about that.

Ms. KEEST. Well, I am afraid there is a—I think it is kind of a little bit of the, "We can do it," "What we can get away with, we will do."

Mr. ELLISON. I think you are right.

Ms. KEEST. I mean, if you look at the way the penalty rates went up after the Smiley decision, which basically said all bets are off around the time the Smiley decision came down in 1995, I think the penalty rates—sorry, not the penalty rates, but the penalty fees—were about $1.7 billion, and in 2005 they were $17 billion, reflecting 10 years of the effect of Smiley.

And just in terms of sort of what people are thinking, I just put a Chase application that I got in the mail regarding the payment allocation system, and they just stuck in there, "You authorize us

to allocate your payments and credits in a way that is most favorable to us."

Mr. ELLISON. That sounds like a good deal.

Ms. KEEST. Yes, who could argue? So I think there is a lot of that, "Hey, let us just push the limit, and see what we can get away with."

Mr. ELLISON. And, in that case, isn't there an important role for Congress to play?

Ms. KEEST. Well, I think there are a lot of people who think that.

Mr. ELLISON. Yes. My next question is this. I have heard—there were some folks on the earlier panel who—we talked about this one practice of universal default. Can you help me understand what legitimate economic basis the practice of universal default might have, as it relates to, say, risk?

Chairwoman MALONEY. The Chair grants the gentleman an additional 60 seconds.

Mr. ELLISON. Thank you, Madam Chairwoman, I will be quick.

Chairwoman MALONEY. To get this answer.

Mr. ELLISON. Other than Ms. Keest's point, which is getting as much as you can, is there any risk-based rationale for this practice?

Mr. HUIZINGA. I think that, as has been mentioned, many creditors have moved away from it. I think I have heard the argument made that if a consumer defaults on one loan, that may be an indication that they may be likely to default on another loan. It may be an indication that there has been a difficulty in their credit situation, or the like, and it may evidence a higher risk on another loan, even though they haven't defaulted on that loan yet.

Chairwoman MALONEY. Okay—

Mr. MIERZWINSKI. I would just add, Mr. Ellison, that the regulators came out with a guidance where they said that if you were going to risk reprice, it must really be based on risk. And so, clearly, so many people getting rid of it, it is probably not based on risk.

Chairwoman MALONEY. The gentleman's time has expired, and the chairwoman recognizes herself to follow up with a question to Ms. Keest.

You mentioned that after the Smiley decision, the fees went up. What do you think the effect of the Wachovia decision on business practices will be? The recent decision.

Ms. KEEST. Well, it would be interesting to see what the folks from the banks here—I would say, on the fees, probably not a whole lot, for the simple reason that the credit card issuers are mostly being issued directly by the banks, anyway, rather than the operating—is that correct?

Chairwoman MALONEY. Would anyone else like to comment?

[No response]

Chairwoman MALONEY. No? No comment? Okay. The Chair recognizes Mr. Bachus for 5 minutes.

Mr. BACHUS. Thank you. There has been a lot of talk about universal default. Now, I can certainly identify with a company that is extending credit, that all of a sudden sees a change in the consumer, or the credit card holder, that indicates that he may be going to have a difficulty. In fact, we have—our credit ratings now

can pick up on some of these trends, although not always accurately.

But let me ask you about this. I have a credit card. I have been told that I purchase stuff, and the interest rate will be 8 percent, and I make $10,000 worth of purchases. Now, all of a sudden I default on maybe not your credit card, but on somebody else's, or my credit score goes down. And that indicates to you, "I am not sure that I want to keep loaning this person money at 8 percent."

I can actually see the equity in saying, "I am not going to loan you any more money at 8 percent," but I don't see the justice or the fairness in saying, "The money I loaned you at 8 percent, all of a sudden, I am loaning you that at 22 percent."

What is your policy on that? Do you suddenly change the rules? And you are going to protect yourself, you don't want to loan any more money to this person. But what is the justification for going back and changing what was an agreement that you had?

Now, you can say, "Well, on page 32 of the small print, we said we could go back and do that," but you know, when you say a rate is fixed for 6 months or a year, you know, to me that indicates—I'm a law school graduate—a contract. I will just start with Citigroup.

Mr. CAREY. Congressman, that is not a practice that we engage in at all. So, if the customer has a problem with another creditor, and becomes viewed with very high risk, we don't change the rate.

Mr. BACHUS. What if they even defaulted on your credit card? Now, do you change the rate, right?

Mr. CAREY. We would change the rate, yes.

Mr. BACHUS. But is it just on new purchases, or do you go back on everything they have borrowed before, and—

Mr. CAREY. No, we would change the pricing. Again, these are in specific circumstances, depending upon the particular credit risk of the individual customer. We might reprice—

Mr. BACHUS. Yes. You know, the thing—

Mr. CAREY.—if they violated an agreement, yes.

Mr. BACHUS. I am going to say this, Mr. Carey. The thing I see about that is that when he is a credit risk, he doesn't pay you, that's right. When you increase his interest rate from 8 percent to 22 percent, he really becomes a credit risk, not only to you, but to other people who have loaned him money.

Mr. CAREY. I understand.

Mr. BACHUS. You know, he probably has a car loan on a fixed rate. He may have a mortgage. And when you suddenly increase his borrowing costs by several hundred dollars a month, you make him a threat, not only to default on your payment, but on other people's.

And then, if he decides to go into bankruptcy, 4 years ago we sort of shut that door, because credit card companies said to us, "We have a problem. People are, you know, we are loaning them money, and they are going into bankruptcy."

Mr. CAREY. I understand.

Mr. BACHUS. And it really has caused a lot of us to say, "What did we do 4 years ago?"

Mr. CAREY. I understand, Congressman.

Mr. BACHUS. But I just don't see the justification. You can change the rules going forward, and I am with you on this. There is more of a justification if he misses a payment. I am not talking if he is 3 days late, but if he is 60 days late, there is more of a justification.

But still, what we are talking about—and I get handed these things all the time, unfortunately. As ranking member, it is the most unpleasant thing, since I have been ranking member. But I do not understand that.

Another thing I do not understand. You loan money and your primary—I think—obligation and also intent is to get paid, is for somebody to reimburse you at whatever interest rate you charge them. But if you charge them 8 percent, but then if they make a mortgage payment—do you all charge them a different—like, if they make a mortgage payment with their credit card?

I don't know if you all heard the story of the young man who—I relayed in my opening statement—used his credit card to make a mortgage payment. All of a sudden, that was 22 percent. So he tried to not only make a minimum payment and pay that off, but he was told that he had to pay all $4,000 or $5,000 at the low interest rate, they applied it to the low interest rate, first, which is obviously to your benefit, I guess—or not you, personally, but the bank.

But it is obviously the most detrimental thing to him, the most unfavorable thing you could do to your customer, and something that he would never agree to with a—

Chairwoman MALONEY. The Chair grants the gentleman an additional 60 seconds.

Mr. BACHUS. I would just maybe ask Citigroup or Capital One, or—and I appreciate you all being here, but what—

Mr. CAREY. I agree with you, Congressman.

Mr. BACHUS. Do you all do that? Do you all apply it to the lowest of the—if he has some money you have agreed at 0 percent or 5 percent or 10 percent, do you apply it to the lowest first, and make them pay all that before you—do you know what you all—

Mr. CAREY. At Citi, we do apply it to the most inexpensive balance.

Mr. BACHUS. Which then, actually, causes his expense to go up, his cost to go up. Does it not?

Mr. CAREY. Yes, it might.

Mr. BACHUS. So you are concerned about being paid, but you are increasing his cost, which—doesn't that just make him more likely to default?

Mr. CAREY. I think you make a very good point about payment allocation, and the overall fairness with that. I believe that that is an area that ought to be looked at, and there ought to be an industry-wide solution to that problem, I agree with you.

Mr. BACHUS. Yes—

Chairwoman MALONEY. The gentleman's time has expired, thank you. Mr. Moore?

Mr. MOORE. Thank you, Madam Chairwoman. Mr. Carey, you said in your testimony that without the ability to differentiate risk, less creditworthy consumers would have fewer appropriate means of accessing credit, relatively risk-free consumers would face a

higher cost of credit, and bank lending strategies would be significantly curtailed.

My question, and I would like, I guess, your comment, your thoughts on this, Mr. Carey, is Citi and some other card companies made the decision to eliminate universal default and so-called anytime, any-reason repricing. Could you talk a little bit more about what the rationale was, and what factors led Citi to eliminate those practices, number one?

And, number two, do you believe those practices should be eliminated across the industry?

Mr. CAREY. Congressman, I would be glad to respond. First of all, we spent a great deal of time talking to consumers on the telephone. We receive 150 million calls a year. We receive over—we have communications with—over 100 million pieces of communication every year. We engage in focus groups, we reach out to customers. We are very—from the customer complaints we receive from the OCC, we react to those accordingly.

We also reach out to many of the community and consumer groups. Some of them are at this table, where we work with them to understand what their concerns are. And also, we have what I would say is a terrific legislative affairs group that works very closely with Members on the Hill, and with State government. And we take that information, and we try to adopt our practices based on transparency, based on fairness, and then based on providing customers the tools to make informed decisions about their lending.

So, you know, I think that answers both your questions, but I am not certain.

Mr. MOORE. No, it doesn't. What about—

Mr. CAREY. Oh, on the individual practices? Oh, no. I agree with you. I think that universal default, I think, is a fundamentally unfair practice, and that is not a practice that we do. We looked at it.

In fact, we looked at it long ago, and we gave customers back in 2005 the opportunity to opt out and still use the card, which was—you know, universal default is the idea that it automatically switches, and you can't opt out, and you can't use the card.

Mr. MOORE. Well, the second question, though, was beyond Citi. And I appreciate what you have said, and I appreciate the decision you all made. Beyond Citi, should these practices be eliminated throughout the industry?

Mr. CAREY. I think Congresswoman Maloney has come across, I think, a terrific idea, which is this concept of a summit, where we can gather together to drive best practices within the industry. And we fully endorse that, we think it is a terrific way to solve a lot of these issues, short of legislation.

Mr. MOORE. She has good ideas, and I would endorse that, as well. Thank you.

Chairwoman MALONEY. Mr. Hensarling, for 5 minutes.

Mr. HENSARLING. I thank you, Madam Chairwoman. Well, along with some of my colleagues, I must admit there are some practices of the credit card companies that don't absolutely thrill me. I haven't quite concluded in my role as legislator, that it is my prerogative to outlaw them.

I will observe, particularly as I reach the ripe young age of 50, I reflect back upon when I attempted to get my first credit card, that very few people would offer me a credit card. Credit wasn't available. And I think 20, 30 years ago, people probably in this very room were debating, "What are we going to do to get more credit to consumers?" And now, to some extent we debate isn't there too much consumer credit out there?

When I finally did get a credit card, one, it had an annual membership fee I had to pay, and the interest rate, compared to today, was exceedingly high. As time has gone by, I observe now there is a dizzying array of offers in my mailbox, practically on a daily basis, from a wide variety of banks. The interest rates are much lower. I can actually get cash back at the end of the year. I can get car rental insurance. I can get frequent flyer miles. I can get donations to my favorite charities. And, if I am able to pay on time, I get interest-free loans from the time of purchase.

Such a deal. I think it should at least be noted that, in a competitive marketplace, good things can be yielded to the consumer. And I can think of no greater consumer protection than a competitive marketplace.

So, I tend to focus on, number one, as I look at these types of issues, is the marketplace effective? And although I did not hear every bit of testimony today, I have not seen a lot of credible evidence telling me that there is not an effective competitive marketplace.

So, typically, I would want to focus on is there effective disclosure? I know some speak of unfair practices, or—and deceptive practices. I care about deceptive practices. But if there is full disclosure, I am not sure there is a lot of commercial transactions between fully informed consenting adults that I care to outlaw, and I continue to be concerned about whether the cure is going to be worse than the ill, in that if we over-legislate, whether credit will become less available, and at higher cost, particularly to those who need it.

But to the more effective disclosure—I shouldn't say more disclosure, but more effective—we have an all-new and improved Regulation Z. I will be the first to admit I haven't poured through all 800 pages of it. But it seems to—and at least in the view of the Fed—takes care of a lot of the challenges that we have today, and perhaps is very prospective in scope, and hopefully, will be in place for years to come.

And, forgive me, I did miss much of the testimony. But to the extent people have managed to review the new Regulation Z, what is it that you would have us legislate that you do not see in the new Regulation Z? And anybody who wants that softball, I will let you have it.

Ms. KEEST. That was actually my assignment to talk about, and so I did talk about it in the written testimony.

Mr. HENSARLING. Forgive me.

Ms. KEEST. What we focused on was the regulation, the proposed regulations, are a considerable improvement, certainly in the formatting, and the understandable stuff. But the problem is with the price complexity—and I will let Ed answer your question about whether or not we have a competitive market with as much market

concentration as we have—that the pricing complexity is really only dealt with by an effective way to sort of try to bring some order to the chaos, to the pricing chaos.

And there are a couple of significant respects where even the Fed has thrown up its hands and said it is too complicated.

And, you know, the cost of credit is principal times interest times time equals dollar signs. And we have all focused on, you know, the rate, which gets messed up with additional charges that complicate the things. And then you also have, mucking around with accounting principles, where they are mucking around with the principle and the time. And the Fed has, actually in a couple of cases, said, "This is too complicated to deal with"—

Mr. HENSARLING. I see my time is about to run out. The tax code is very complicated, as well. Somehow Americans manage to plod through that each year.

I would also have a fear, though, that if we try to homogenize this product, then the innovation from the marketplace might leave us—with that, I see the red light has come on, Madam Chairwoman.

Chairwoman MALONEY. Thank you. The chairwoman recognizes herself, following up on his questioning on the disclosure.

In discussions with some banks, they have cited to me anti-trust concerns as a reason for not amending their disclosures and making them clear, and help consumers understand them more.

I would like to ask the issuers, with the new Reg Z, does that take care of the concerns? Some banks have told me, "The reason we hand out 30 pages worth of information on this is because our lawyers tell us to, and we need to." But with the new Reg Z, well, do you see the industry voluntarily following the recommendations that the Fed has come out with, even though there is a comment period that extends until October with the clear stating of fees and so forth? Do you see any change now?

I would like to start with Mr. Carey. And if there are issuers—anyone who would like to comment, but I would like to hear from—

Mr. HUIZINGA. I can address that question.

Chairwoman MALONEY. Okay, sure.

Mr. HUIZINGA. In terms of litigation, I think one of the things that issuers have struggled with is that these credit card products can be complicated. And there has been a lot of litigation over the years by consumers, challenging that the terms were not clear enough.

And many times, the response to that has been to make them longer, to get into the detail. If someone didn't understand a particular point, to write a paragraph on that. And then, when somebody else didn't understand another point, to write a paragraph on that. And we ended up with very long disclosures, which I think everyone admits are not as effective as they should be. And I think the Fed's approach in Reg Z, really, is designed to address that.

The Fed has tried to distill the key points that are important to consumers in shopping for credit, and to try to put them in a table, and in a way that can be easily understood. So, I think that is being addressed, in terms of moving from densely written disclosures that are very difficult to understand, to tables and sum-

maries that have limited the information, hopefully in a more manageable way, so that people can shop better.

Chairwoman MALONEY. Not only can people shop better, we have heard testimony from very sophisticated people—including the head of Freddie Mac—that he could not understand his credit card disclosure form.

But I would like to ask Mr. Carey and Mr. Caywood and Mr. Finneran with the new Reg Z, what impact does that have on you? Will you be changing your disclosures? Will you be making any changes because of Reg Z, or—

Mr. CAREY. Oh, yes. I mean, the—what is terrific about the Reg Z proposal is that, really for the first time, there is uniformity about format, type face, language, they have provided amount of language, designed to allow customers to truly understand the products that they—or services—that they want to acquire.

And what is also good about it is that it is at each stage of the customer's interaction with the lender. So, when you are applying for a card, there are certain rates that are very important for you to know, very key things you need to know. That is important. When you get your card agreement and your credit card, they are laid out very much like the food labels.

Chairwoman MALONEY. Yes.

Mr. CAREY. The American public have gotten used to the food labels—

Chairwoman MALONEY. So you see industry conforming to what—

Mr. CAREY. Yes, yes, I do.

Chairwoman MALONEY. Great. The Chair recognizes Mr. Clay.

Mr. CLAY. Thank you, Madam Chairwoman. I have two examples of true experiences in my district of adverse dealings with credit cards. And this example and question are for Mr. Carey, Mr. Caywood, and Mr. Finneran.

An 87-year-old female constituent was a caretaker for her sister. Ms. Mary Cutty dutifully paid her bills without always auditing the statements, as she was involved with her sister, and was trusting of the system. Her sister was recently transferred to a care facility, as the task got to be too much for Ms. Cutty.

During the time that her sister was with her, there were two incomes in the home, and although bills increased, timely payments were made. Once the sister's income was given to the care facility, Ms. Cutty was very meticulous with her bills, because she had more time and less money.

She was shocked to discover that her interest rate had increased to over 30 percent. She called my office as a last resort. And in distress, she tearfully explained her situation and said that she simply would never be able to pay off the debt at that percent rate. Now, she was in complete despair. She said that she is considering bringing her sister back home, because they may not be able to afford to live apart.

Do we have to make money off the backs of Americans in their golden years with these cloaked methods of raising rates? If the intent is not predatory, surely the result is. How do we assist the Ms. Cuttys of this country? Can anyone try to tackle that?

Mr. CAREY. Congressman, what you describe is, I think, a terrible situation. That is not—it is awful. I agree with you. I think that it is not the right thing to do for individuals.

And if it is our customer, we would—we want to talk to this customer, we want to engage with this customer, we want to help this customer. Generally, we find if we can talk to customers who are actually in true financial distress, we can work those things out. And we want to encourage people to engage with us.

We are not interested in throwing people over the edge, throwing them out of the life boat. That is not what we do, that is not a practice that we want to do. People do find, through life circumstances, that terrible things happen to them. And when that happens, at least the company that I work for steps up and says, "We have to make it right."

Mr. CLAY. Mr. Carey, I am encouraged to hear that. Let me give you one other example.

Consumers are often shocked by the impact of penalty payments and fluctuating interest rates. A true example was given to me by a student in my district, and the student happens to be here today, interning for me.

This student purchased three cups of coffee that sent her beyond her credit limit each time. Because the penalty charges are $35 for each transaction, the student ended up $120 in debt for the three $5 charges at Starbuck's, plus the overage penalty payment.

Would it not make more sense to lower penalty payments? Wouldn't it be a simple procedure for the credit card company to just decline the sale? How do we get away from this culture of force-feeding cards to students, knowing full well their limited incomes and the likelihood of overcharging—since it was a Bank of America charge, Mr. Caywood, can you address it?

Mr. CAYWOOD. I would be happy to address it. First, I can tell you that in any given month, you can't get more than one overlimit fee from Bank of America. So, the three cups of coffee, for that to occur, would have to be in three different months, which is possible. But we do cap the number of consecutive over-limit fees for any customer at three.

So, we are very careful to make sure that we have that policy in place, and that we don't have repeated over-limit charges just continuing to occur on a customer that is stuck over their credit limit.

Mr. CLAY. Thank you for that response. And Mr. Finneran, Mr. Mierzwinski talked about due dates. Can consumers ask and receive a change in due date?

Mr. FINNERAN. Yes, sir. They can.

Mr. CLAY. And what is the procedure, just to call?

Mr. FINNERAN. Yes, the procedure is to call us, and we can adjust the due date and change their billing cycle to fit their particular circumstances.

I would also note that with respect to due dates, we actually have, at Capital One, one of the longest cycle periods in the industry, the effect of which is to give people more time to pay their bill after they receive it, and still be on time.

Mr. CLAY. Okay. How do you feel about accepting the postmark date as the time of payment, in order for the customer to avoid the late payment?

Mr. FINNERAN. I think it has a lot of operational complexities with it. We do provide to our customers multiple ways to pay their bill. In addition to getting the bill out on time, we certainly encourage them to pay on time and we seek to help them out as much as we can, as circumstances warrant.

Mr. CLAY. Well, Mr. Finneran, you know that most billing operations do accept the postmark date of the U.S. mail that is sent to those offices. Why would credit card companies have such difficulty?

Mr. FINNERAN. Well, with all due respect, sir, I am not sure that is right. I believe most people expect to receive a payment by the time of the due date, and that business practice is with more than just credit cards.

Mr. CLAY. It is the custom of most billing—

Chairwoman MALONEY. The Chair extends 60 seconds.

Mr. CLAY.—of most billing departments to accept the postmark date. And I mean, I think that is only reasonable. If someone intends to get the payment there on time, I don't see why the company cannot honor that intent.

Chairwoman MALONEY. And the gentleman's time is expired. Mr. Davis of Kentucky?

Mr. DAVIS OF KENTUCKY. Thank you, Madam Chairwoman. That—

Mr. BACHUS. Madam Chairwoman, could I—I have to leave for a few minutes, but could I ask unanimous consent that after he gets through, Mr. Price could go, so—

Chairwoman MALONEY. Sure, absolutely.

Mr. BACHUS. Thank you.

Mr. DAVIS OF KENTUCKY. I think that Congressman Clay brings up an interesting area of interest—no pun intended. But the—when looking at hardship situations that can occur, you can get into a cycle with the numbers and make it, you know, very problematic.

And one of the questions in my mind, as coming to this committee as a business owner, you can hit a point on attempting to collect a debt that the cost of the collection actually will vastly outweigh the principal at the end of the day, and there comes a business cost that is somewhat problematic for someone who is already in a financial hardship situation, especially if you have a senior citizen who perhaps gets into a situation where they may be confused later in life, dealing with illness, or other things that might occur.

And I was wondering if you might comment for a moment on how you deal with hardship situations. Maybe start with Mr. Carey.

Mr. CAREY. Well, sir, actually, I think it is a terrific program. In many ways, when customers come to us, and they say they are having difficulty paying their bills on time, we have a number of programs where we will work with the customer on an individual basis, either in a temporary program—say, for example, there is a loss of job, a temporary loss of job, or a temporary illness.

I mean, we will go to the point of, in essence, extending interest-free lending, suspending minimum payments, or lowering minimum payments, in many ways, to try and accommodate the customer's individual need.

Sometimes an individual is in way over their head, and there isn't an ability to dig out. We will work with those customers to try and find an arrangement that makes the most sense.

So, I think your point is exactly right, that at some point it doesn't make a lot of sense to do it. It's also probably not the right thing to do, anyway.

Mr. DAVIS OF KENTUCKY. In context—and perhaps Mr. Finneran can follow on the same line—if you get into a situation—for example, I will go back to the senior citizen situation, where just a family member—I ended up walking through this process with them, and watching this occur, firsthand—they come to you. You recognize the situation.

At what point do you make the decision, you know, both from a business and a moral decision, to actually write that down, write that credit off, absorb the loss, based on, you know, how you have already managed risk and you have assessed risk?

Mr. FINNERAN. Sir, maybe I will go first. I think our program is similar to the one that Mr. Carey described. I think we try to work with each individual customer, based on their individual facts and circumstances.

I think the key here is that we do try to encourage people to let us know when they are having difficulties, so that we can engage in that dialogue and see if we can come up with a solution that works for both parties.

Mr. DAVIS OF KENTUCKY. At what point do you move from—what triggers, causes you to move from an increasing interest rate to, let's say, more of an act of grace towards that customer?

Mr. FINNERAN. I'm sorry, sir, I'm not sure I follow the question.

Mr. DAVIS OF KENTUCKY. Well, you know, having watched some of these situations occur, where debt will mount up, or payments are missed, and obviously something is wrong at some point, at what point does the company, in the dialogue with the customer, when a collection action is in process, make the point to go to another track, recognizing that collection is not going to be an effective activity?

Mr. FINNERAN. It could be at multiple points in the dialogue with the individual customer, sir. It just depends upon the facts and circumstances of each individual case.

Mr. DAVIS OF KENTUCKY. Yes, I have to just say for the record, I was actually pleasantly surprised in a situation that we saw at a distance with a senior citizen who—I am not going to name the company at the time—but that actually, I think, did something very humanitarian, in terms of helping an elderly person manage their way out of a problem that was very significant, actually discouraged payment because of fixed income implications, and things like that, that, you know, it's part of the story that doesn't get told.

Although, at the same time, I think we are dealing with interest rates that can be prohibitive in certain cases for individuals. But that leads me into another question.

There is always kind of a yin and yang balance that we run into here in dealing with the availability of credit as we push that floor downward, and how you effectively measure risk, and regulation. And, certainly, we want to have a very strong advocate for protecting consumers, particularly things, legislation I have personally worked on since I have been in Congress for our military personnel, to protect them from predatory lending practices and other sorts of schemes.

But to Mr. Mierzwinski, and Ms. Keest, one question that I have is, you know, can we go too far, in a regulatory environment, to create a situation that causes credit to be pulled back from those who may, in fact, be in that need, at the same time providing an adequate balance for consumer protection?

Mr. MIERZWINSKI. Mr. Davis, if I could answer your previous question to the bank witnesses first, I would just point out to the committee that while the programs of these banks may be good programs for dealing with mitigating the risk of payments that people in hardship can face, I would also point out that the regulators have issued guidance requiring all banks to have programs like that, and it may be useful for the committee to ask further questions of the regulators, as to how did they enforce, and how do they know about how, significantly, all the banks are providing those hardship-based functions.

Because that is one of the real problems out there, when a consumer calls a bank, does the bank just say, "You better pay, or else," or does the bank say, "We would like to work it out," and they are supposed to have special work-out programs.

On your other question, obviously, it's always the issue. I personally don't think the Congress can go too far. I think you need to go further than where the Fed went.

And I would encourage you that banning unfair practices is not going to eliminate the availability of credit. I think banks want new customers, banks are trying to find new customers, and they are trying to make credit available. And banning unfair and grotesque practices, you can still make a lot of money in this business. The problem is, they are making money with unfair practices on top of the good money that they deserve to make.

Mr. DAVIS OF KENTUCKY. And you mentioned, you know, grotesquely unfair practices. What do you think is the most egregious one that you point to? And, again, I come back to the—

Chairwoman MALONEY. The Chair grants an additional 60 seconds.

Mr. DAVIS OF KENTUCKY. Thank you.

Mr. MIERZWINSKI. Well, first, universal default, retroactive balance, being charged two penalty interest rates, changing the rules without notice, and the practice that Mr. Bachus talked a great deal about, which is to have your payment applied to the lowest portion interest of your entire bill.

I could go on and on, but it is all outlined in detail in my testimony.

Chairwoman MALONEY. The time is expired. Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. I have just a couple of questions. Would all of you support a measure that would

bar the issuance of credit cards to people under 18, unless they have a signature of a parent or guardian who would assume responsibility for the charges, or prove that they have means to repay the debt?

Would all of you support—well, maybe who would not support that? Who thinks that is a bad idea?

Mr. FINNERAN. I believe that is already the law in almost every State.

Mr. CLEAVER. It can't be.

Mr. FINNERAN. For people under 18.

Mr. CAYWOOD. It is certainly already our practice at Bank—

Mr. FINNERAN. It is certainly the practice of Capital One, and it is certainly the law in the State of Virginia, where we issue from.

Mr. CAREY. It is our practice, at Citi, as well.

Mr. CLEAVER. So, then, what we need to do is move it up to college-age students who are unemployed?

Ms. KEEST. I think most people think that loans should be made where there is ability to repay them, which means underwriting your loans.

Mr. CLEAVER. I am sorry?

Ms. KEEST. I said I think most people think that a loan should be made where there is ability to repay them, which means that they should be underwriting the loans.

Mr. CLEAVER. Yes. I call your attention to the article that I showed earlier today that was in the Washington Post today, with a young woman who—although she is 28 years old now, she was in college, and left college with a $5,000 credit card debt.

And my son, who is in college in California, he is over 18, but that is about the amount of money he has, $.18. And he comes home with a credit card, you know, from school. And I don't believe in violence. He had only put $60 on it, on the credit card, but I could not imagine who would send Evan Cleaver a credit card.

I mean, he is my son, I—you know, I feel uneasy putting money in his account while he is in college. And so the problem is when students are still in college, maybe they are 20, maybe they are over 18, but there is still a problem. Don't you agree?

[No response]

Mr. CLEAVER. Do any of you agree? Do any of you have children in college?

Mr. CAREY. I have a child in college, and actually, my son is here. And he does have a credit card, which he applied for, because he has some income, and he is able to manage his credit wisely.

I was not able to get a credit card when I was his age, and so therefore, I couldn't have access to the services that he is able to have access to.

Mr. CLEAVER. I was in the same situation, but you just hit it on the head. The issue is he has a job. He is able to pay his credit card debt. But there are students who receive the credit card while they are in college who are not employed. And I mean, it is in today's newspaper.

Mr. MIERZWINSKI. Mr. Cleaver, you are raising a very fair point, and we have looked at this, and a number of bills, I believe, that have been considered say that a young person should be treated as anyone else. You either have to have a credit report that has a

good score, or you have to have a job, or you have to have a co-signer. Or, in some of the bills that have been proposed, you at least have to have taken some sort of financial management course. And—

Mr. CLEAVER. That is in the bill I have introduced.

Mr. MIERZWINSKI. Right. So the issue is right now they are just giving them away like candy, without any of that, because they are relying on the fact that they can make a debt collector call to the consumer and suggest you are going to have 7 years' bad luck. Maybe your parents ought to pay, even though they are not co-signers.

Mr. CLEAVER. I paid the $60. I mean, nobody else was going to pay it, he was going to go to jail. I do not believe in, you know, in violence, but I was going to shoot him in the leg if it had been higher.

But the point I am making, which nobody wants to agree with, when you are sending credit cards to students in college, you know, there ought to be some evaluation of their capacity to pay. And you are going to say that there is, and I am telling you that all you have to do is go and talk to college students. They are getting credit cards, and they are being solicited.

Chairwoman MALONEY. The Chair grants an additional 60 seconds for an answer, and then calls upon Mr. Price.

Ms. LANDIS. I am not a credit card issuer, but if I could make one statement that is a concern from small business, I appreciate the fact that you ought to be able to repay it to get the credit card.

What concerns me is if a regulation or a law were passed that said I had to prove income. What would I, as the owner of the company, be required to send in to prove income, that I could get the credit card to finance my business?

So, that has been the concern, as I am listening to much of this testimony. Keep in mind that there are two groups of folks who use credit cards. There are individuals who use them for their personal purposes, and would pay that with their salary, and then there are businesses who use it to finance capital expansion of their business, and they are repaying that from the funds of their business.

Mr. CLEAVER. Okay, I have a response, but I will wait. Thank you.

Chairwoman MALONEY. Thank you. Mr. Price?

Mr. PRICE. Thank you, Madam Chairwoman. I appreciate that. And just let the record show that I agreed that Mr. Cleaver ought to go before me on the previous questioning.

I want to thank the panelists for being here. Somebody—I was trying to remember who said it. Somebody once said that Congress does two things well: nothing; and over-react. We have done a lot of nothing for a long time regarding this issue. My concern and my fear is that we may be about to over-react.

I am struck by the importance of financial literacy. Many of us have supported the need for financial literacy, and for a general education of our young people about the—what it means to take on credit, and take on debt.

And I am also struck by the lack of mention of any personal responsibility in this discussion. It strikes me as curious that—and I don't mean to cast aspersions on the individual in the Wash-

ington Post article, I haven't seen that, but it strikes me that she ought to have, at some point, recognized that $5,000, or getting to that point, was more than she was going to be able to repay.

And I know that is heartless and cold, but I have experienced that myself, years ago, longer than I care to admit. I was an undergraduate and received a credit card, and charged too much, and learned a wonderful lesson. And that was that when you charge something, it comes due. And so, I suspect that I am a more wise consumer and individual, as it relates to gaining credit now, because of that experience.

I have a couple of questions. Ms. Keest, the 2006 GAO report—and just, in general—I think it talked about the percent of debt as a percent of income in our Nation, as it relates to history, and it is approximately, as I recall, the same as in the 1980's, I think, as in terms of overall household debt.

And I wonder if you would comment on that, as it relates to the degree of problem that we have. Or, am I inferring an incorrect conclusion?

Ms. KEEST. I don't recall that specific statistic. I don't think that is correct. It is my understanding that we are at—in terms of debt compared to disposable income—at historic highs, and that revolving credit, the growth of revolving credit, has added a lot to that.

Mr. PRICE. So—and "revolving," you mean credit card debt?

Ms. KEEST. Yes.

Mr. PRICE. So, credit card debt you believe to be a significant increase in percentage of overall debt that we have right now, is that correct?

Ms. KEEST. I believe so.

Mr. PRICE. Okay.

Ms. KEEST. I would have to go back and check. But I think in some of the other hearings that Congress has held this year, there have been some charts on that.

Mr. PRICE. Okay. I have to go back and look at that report. I appreciate that.

Does anybody use universal default? Anybody here use universal default? I didn't think so.

I want to talk a little bit about interchange fees. There is growing attention being brought to the use of interchange fees. And I am interested in anybody on the panel's comments regarding—my understanding is that there is no true regulation of interchange fees right now. I think Mr. Greenspan spoke last year, or the year before, about the Fed taking a look at that, or gaining more interest in that. I wonder if anybody might comment about the role of governmental regulation as it relates to interchange fees, support for that, and potential consequences.

I must have missed some testimony. Mr. Huizinga?

Mr. HUIZINGA. I could briefly answer that. An interchange is compensation that is paid by one bank to another bank in the bank card system.

Mr. PRICE. Right.

Mr. HUIZINGA. It is paid by the bank that provides the merchant services to the bank that issues the card.

Merchants, in turn, will pay a merchant discount to their merchant bank, which many times will include—or typically does in-

clude—the interchange. Currently, the merchant discount is paid by the merchant, in exchange for the merchant receiving services or benefits—

Mr. PRICE. Do we need regulation?

Mr. HUIZINGA. I don't believe so.

Mr. PRICE. Anybody think we need regulation of interchange fees?

Mr. MIERZWINSKI. Mr. Price, the consumer groups have testified on this matter in other committees, and we are very, very concerned about the fact that everybody pays more at the pump, including people who pay with cash, because the interchange issue is a problem.

Now, it may be resolved through the litigation that is occurring in the private anti-trust matters, but we are still looking at it very closely.

Mr. PRICE. Ms. Landis, do you have any comment about interchange fees, and how they relate to small business?

Ms. LANDIS. Interchange fees are a big cost for small business, there is no question about it. And it comes back to many of the things we have talked about here today.

Business understands a contract, as several of you have said. If we enter a contract, we know clearly what we are getting into, and what our costs are. We can deal with it. It is the changes, the unpredictability that small business can't absorb fast enough in its pricing.

Mr. PRICE. Thank you very much. My time is expired. I appreciate your testimony.

Chairwoman MALONEY. Mr. Perlmutter.

Mr. PERLMUTTER. Thank you, Madam Chairwoman. And mine is more of a statement, I guess, than questions, because I missed so much of the panel's testimony. We were working on a stem cell bill which we believe affects about 110 million or 115 million people, potentially has promise for that many people.

Based on what I heard initially, credit cards probably touch 200 million people. And I was in our State senate, I have been here—I probably voted 10,000 times or more, and on Iraq, on immigration, on everything. And I will tell you the one type of vote that affects most people directly is on credit cards.

And you know, my background is as a lawyer, representing banks and credit unions and financial services companies. There is a populist movement out there, concerned not so much about, you know, the boxes and, you know, the exact language of the disclosure, but by the rates and the fees themselves.

And I think, you know, what we see from the poorest, who take advantage of credit cards, because it provides a great service, to the wealthiest—and it was Mr. Bachus who really struck the chord right out of the box, he had a businessman who kept getting different charges, he couldn't understand them, and finally he just paid it off.

And then, we had the Governor from the Federal Reserve Bank talk about risk-based lending. Well, I'm not really sure what that means. I think this is profit-center-based lending.

My concern is I have people in my district, business men and women, who want to establish usury limits, outlaw fees, outlaw,

you know, a whole variety of things. That is against my sort of button-down nature. But that feeling out there is growing, and we get complaints day after day after day about credit cards.

So, you know, I am just looking at the fees outlined in the proposed Reg Z boxes, you know. You think that you closed your account, then you get stuck with a $60 closed account fee, or a maintenance fee. You don't pay that, then you get a late charge on it. And pretty soon, either you have to deal with all the people on the phone to get them to eliminate that, or you pay it, just to be done with it.

So, you know, my question is, I am looking at the—to anybody on the panel, in the fee box, if you have it in front of you, the applications and solicitations, sample credit card boxes, are all those—do any of you have—and I guess I am asking the credit card folks—do you have any fees that aren't listed in that box? Like a telephone fee, if you pay your account over the phone, do you get charged for that?

Mr. CAREY. We have a number of fees that are not.

Mr. PERLMUTTER. Listed?

Mr. CAREY. No, no. They are here that we don't have.

Mr. PERLMUTTER. Okay. But those that you do are listed?

Mr. CAREY. As best as I can tell right here.

Mr. PERLMUTTER. You know, really, my concern again just goes to what people believe. Again, I think Mr. Ellison said it early on, you know. People in the middle are getting squeezed. And there is a belief that, you know, that you get nicked here, and you get nicked there, and you get nicked here, and you get nicked there. And there is a point where folks revolt and rebel.

And, you know, obviously, people have a choice to use credit cards or not, but people are in a desperate mode, and desperate people do desperate things. They will use the credit cards.

And if we go to risk-based lending and bankruptcy, the bankruptcy code was changed to favor—to assist lenders and credit card issuers. I don't know, and maybe you all could tell me, was there any reduction in interest rates or fees, because there was the elimination of a bankruptcy risk, or the reduction of a bankruptcy risk? Do we see that in sort of this risk-based lending? Anybody?

[No response]

Mr. PERLMUTTER. Okay. I mean, my stuff is rhetorical. I guess I am just saying Senator Dodd suggested that everybody take a good look at their practices, take a good look at—I am saying you take a good look at the spread, you know, over the discount rate, and what you're earning on these things, and you know, help us out voluntarily, if you can, because Dr. Price is right.

You know, there hasn't been real oversight of this area for a long time, and I don't want us to over-react. I don't want us to take a blunderbuss, and start passing usury laws, and things like that, that really do tighten the credit, hurt people we don't intend to hurt, but to try to act because we have so many people who are feeling squeezed by these different things.

And Madam Chairwoman, that is all I wanted to say. Thank you.

Chairwoman MALONEY. Thank you for your question, and I thank all the panelists. We have been called to a vote, and the Chair notes that some members may have additional questions for

the panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit those questions, and to enter the responses into the record.

I thank you very much for coming. The meeting is adjourned. Thank you.

[Whereupon, at 3:09 p.m., the hearing was adjourned.]

A P P E N D I X

June 7, 2007

U.S. Congresswoman
Ginny Brown-Waite
Representing Citrus, Hernando, Lake, Levy, Marion, Pasco, Polk, and Sumter Counties

Subcommittee on Financial Institutions
Hearing on "Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives"
June 7, 2007
Statement for the Record

Thank you Madam Chairwoman for holding this hearing, and thank you to the witnesses who are testifying before us today.

Let me say this at the outset: credit cards, and those issuing them, are not the demons many make them out to be. For many Americans, revolving credit will be their first experience in establishing a financial track that will last them throughout their lives. For others, including myself, credit cards offer convenience and rewards that Americans relish. Regardless of their purpose, credit cards are a permanent part of American purchasing society.

In any market, bad players exist – unscrupulous vultures that prey on the needy and uninformed. Because of this, some of those testifying today want Congress to make every decision possible for consumers. However, I believe in the intelligence of the American public. If consumers are armed with the information needed, they alone will make the decisions that benefit them the most.

Consumers – whether they are college students opening their first credit card or a new family taking advantage of an awards program – should be fully aware of the fees, penalties, and advertising practices credit card providers engage. Furthermore, the disclosures of that information should be in plain English, prominently displayed, and easy to understand to the every day consumer, because let's be honest, very few of read "the fine print." Consequentially, I am optimistic that the efforts the Federal Reserve is taking to rework Regulation Z will be the next step in providing this consumer ammunition. The market and consumer needs have changed over the past 40 years, and the proposed improvements are a step in that direction.

There is no question more improvements could be made, and I remain concerned over the practice of universal default, raising rates on previous balances, and charging interest on a balance already paid. Regardless of whether Congress prohibits these practices, their

consequences should also be spelled out in large font, plain English before consumers are assessed penalties and fees.

I look forward to hearing from our witnesses today any additional steps Congress can take to further protect consumers so they can enjoy the benefits of revolving credit.

Thank you again Madam Chairwoman for holding this hearing today.

Hon. Julia Carson

Financial Services Subcommittee on Financial Institutions Hearing "Improving Credit Card Consumer Credit: Recent Industry and Regulatory Initiatives"
June 7, 2007

Thank you Chairwoman Maloney and Ranking Member Gillmor for holding this important hearing today. I would like to state that I believe credit cards serve an important role for consumers. For many individuals, it may be the first chance they have to build credit. Increasingly, however, consumers are relying on credit cards for more essential expenses such as medicines and mortgage payments. This reliance has resulted in a nation with household debt far exceeding disposable income and revolving debt of over $800 billion.

The Federal Reserve has taken a critical step in amending Regulation Z to enhance consumer understanding of credit card agreements and disclosures. I am very pleased with many of the changes such as the increase in the days required for notification for a rate change and the prohibition in advertising a fixed rate when the issuer reserves the right to change the interest at their discretion.

While I am pleased with many of the changes, I have some concerns as well. I am apprehensive about the new, limited list of fees required to be disclosed. It seems to me that it would be simple for issuers to simply come up with new and creative fees that would not have to be disclosed. While the list is intended to make fee disclosure more understandable, I am concerned that this may lead to a new avenue for issuer abuse.

I also believe much more needs to be done to address the predatory and abusive credit card practices that are so prevalent today; especially in light of how heavily consumers have come to rely on credit card financing. Enhanced regulation is needed to reign in practices such as double-cycle billing and universal default which are so clearly taking advantage of consumers. This problem is especially relevant in the subprime market where consumers accumulate incredible debt due to annual fees, activation fees and monthly maintenance fees. These customers are approved for high credit limits and allowed very low minimum payments for the purposes of setting them up for incredible fees.

I look forward to future discourse on these issues and I look forward to your testimony on these important changes by the Board.

Opening Statement

Congressman Paul E. Gillmor (R-OH)

June 7, 2007

Hearing Entitled: *Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives*

I'd like to thank the Chair for calling this hearing today. Americans today have access to some of the best financial services in the world. A critical part of these services is the credit card.

The credit card industry has expanded rapidly over the past decade with close to 700 million cards in use today and if my mail-man had his way, I'd have a few thousand more. The popularity of the credit card as a payment option has allowed for an evolution of credit card policies and fees. There are literally thousands of products offered by credit card issuers all with different fees, rates and features. With market competition and innovation, credit card issuers seem to be willing to adjust their products when consumers dictate that a change in necessary.

Recently, several of the largest credit card companies voluntarily modified some of their risk-based pricing policies such as double-cycle billing. I would expect this trend to continue as a consumer with a bad deal can now shop around with ease.

Due to the nature of credit cards, fees are a major component of how an issuer is able to recoup the dangers of extended credit with no collateral. It is fair for banks to constantly evaluate how best to charge for the risks associated with particular segments of borrowers. What is unacceptable is for the issuers to hide fees, policies or practices from their customers.

Disclosure is a major part of the answer and that is why earlier this year Ranking Member Bachus and I sent a letter to Fed Chairman Bernanke requesting a prompt review of Regulation Z.

I am pleased with the work of the Federal Reserve in putting out this proposal. By completely overhauling the notices presented to prospective and active credit card customers, consumers should be in a much better position to evaluate their terms and to shop around. In particular, I was pleased to see the Federal Reserve attempt to simplify the disclosure of fees and interest. By presenting the consumer with a box detailing their interest rate charges and fees for the year, the periodic statement will become a wake-up

call for some Americans who have experienced the problems of wreck less spending.

From this multi-year exercise and extensive consumer testing, the Fed hopefully has a clear picture of what the average credit card customer understands about their account and what they do not.

I look forward to closely examining the comments offered by the witnesses today and to further revisions to this proposal. I thank the Chair and yield back the balance of my time.

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EMBARGOED UNTIL DELIVERY

STATEMENT OF

SHEILA C. BAIR
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

IMPROVING CREDIT CARD CONSUMER PROTECTION: RECENT INDUSTRY AND REGULATORY INITIATIVES

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

of the

FINANCIAL SERVICES COMMITTEE
U.S. HOUSE OF REPRESENTATIVES

June 7, 2007
2128 Rayburn House Office Building

Chair Maloney, Ranking Member Gillmor and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding consumer and regulatory issues related to credit card practices.

The credit card has been a landmark innovation in consumer finance, allowing consumers unprecedented flexibility to access credit. This flexibility, in turn, has fueled economic growth by making it more convenient for consumers to purchase goods and services. Yet, like all credit, credit cards can create economic hardship if not properly managed or if consumers are confused or misled regarding the terms and conditions of use.

My testimony will discuss recent trends in credit card lending, as well as the FDIC's role as insurer and supervisor of institutions engaged in this activity. I also will discuss credit card practices that have raised concerns at the FDIC.

Credit Card Industry Trends and Statistics

Beginning in the late 1970s, interest rate deregulation, combined with the development of credit scoring models and risk-based pricing, allowed lenders to price credit for a wider range of borrowers. In addition, consumer loan securitization increasingly provided wholesale funding for credit card lending. These developments helped spur rapid growth in the credit card industry through the 1980s and 1990s.

Revolving consumer credit outstanding -- which is made up primarily of credit card debt -- nearly quadrupled during the 1980s, and then almost tripled in the 1990s. The growth rate was as rapid as 27 percent a year in the mid-1980s. As of first quarter 2007, revolving credit outstanding was approximately $888 billion (seasonally adjusted), up 7.56 percent from the first quarter of 2006.[1] This was the fastest growth since 2001, although relatively slow by historical standards.[2]

Credit card lines have been part of a trend of rising household debt in recent decades. The ratio of total household debt to disposable personal income has more than doubled over the last 20 years, climbing to more than 125 percent.[3] Much of the rise in household debt is due to mortgage obligations, but credit card debt grew from 2.7 percent of annual personal disposable income in 1980 to 9.2 percent in 2006.[4] Revolving credit, including credit cards, became an increasingly important component of consumer credit during this time. Revolving credit as a share of total consumer credit[5] outstanding grew from 16 percent in 1980 to 37 percent in 2006.[6]

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[1] Revolving consumer credit outstanding includes revolving consumer credit held by finance companies, credit unions and non-finance companies in addition to insured commercial banks and savings institutions and a pool of securitized assets. Combined, finance companies, credit unions and non-finance companies held approximately $107 billion of revolving consumer credit in the first quarter of 2007 on a non-seasonally adjusted basis. Federal Reserve Statistical Release G.19 Consumer Credit.

[2] The average year over year rate of growth of revolving consumer credit outstanding between 1980 and 2006 was 11.1 percent. The average year over year rate of growth was 14.9 percent between 1980 and 1989, 11.3 percent between 1990 and 1999, and 5.4 percent between 2000 and 2006. See Federal Reserve Statistical Release G.19 Consumer Credit.

[3] Household debt comprises (1) loans secured by real estate, such as mortgage loans, home equity loans, and home equity lines of credit, and (2) consumer debt, either revolving or nonrevolving, incurred to purchase a good or service, including automobiles, mobile homes, trailers, durable goods, vacations, and other purposes. FDIC calculation based on Federal Reserve (Flow of Funds and G.19) and Bureau of Economic Analysis data.

[4] FDIC calculations based on Federal Reserve Statistical Release G.19 Consumer Credit and Federal Reserve Flow of Funds data.

[5] Consumer credit includes most short- and intermediate-term credit extended to individuals. Consumer credit is the sum of revolving credit (credit card credit and balances outstanding on unsecured revolving lines of credit) and nonrevolving credit (such as secured and unsecured credit for automobiles, mobile

At the same time, revolving credit has not grown substantially as a share of total household debt. Consumer credit reports show that credit card balances represented only 11 percent of total reported household debt in the fourth quarter of 2006. This figure has been relatively steady since the early 1990s.[7]

Meanwhile, mortgage debt grew from 66 percent of total household debt at the beginning of 1992 to 75 percent by the end of 2006.[8] The Tax Reform Act of 1986 stimulated demand for mortgage debt by retaining the deduction for home mortgage interest while eliminating the deduction for nonmortgage consumer debt, such as car loans and educational loans. The tax-deductible status of debt secured by homes made mortgage debt a more attractive after-tax financing option than nondeductible consumer debt.[9] In recent years, many consumers may have been using home equity loans or cash-out mortgage refinancing to pay credit card balances. A 2002 Federal Reserve survey found that approximately 26 percent of mortgage refinance funds were used to pay off other debt.[10] The switch from consumer debt to mortgage debt in recent years was evident in that growth in home equity lines of credit outstripped growth in credit card debt, even though the average interest rate for credit cards declined.

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homes, trailers, durable goods, vacations, and other purposes). Consumer credit excludes loans secured by real estate (such as mortgage loans, home equity loans, and home equity lines of credit).

[6] FDIC calculations based on Federal Reserve Statistical Release G.19 Consumer Credit.

[7] TransUnion LLC., TrenData database. All data received were depersonalized and aggregated from consumer credit reports.

[8] Ibid.

[9] "Breaking New Ground in U.S. Mortgage Lending", "*FDIC Outlook*, Summer 2006.

[10] Glenn Canner, Karen Dynan, and Wayne Passmore, "Mortgage Refinancing in 2001 and Early 2002," *Federal Reserve Bulletin*, December 2002.

The expansion of credit card lending has touched households across the credit spectrum. Today, more households are using credit cards than ever before. Data from the Federal Reserve's Survey of Consumer Finances show that 75 percent of households have some type of credit card. The share of households with credit card balances has also risen, climbing from 40 percent in 1989 to 46 percent in 2004, while the median level of indebtedness for households with credit card debt grew from $1,300 to $2,200 (in 2004 dollars).

Growth in credit card ownership and usage has been especially significant among lower income households and young people. Nearly 30 percent of households in the lowest income quintile[11] held credit card debt in 2004, up from 15 percent in 1989. Almost one-third of households in the lowest income quintile report that they hardly ever pay their entire balance in full, and 16 percent admit having had a debt payment 60 days or more past due.[12]

Data show that young adults today are more indebted than previous generations were at the same ages and appear less likely to make timely debt payments than other age groups. The average credit card debt held by young adults ages 18 to 24 and 25 to 34 grew by 22 percent and 47 percent, respectively, between 1989 and 2004.[13] In 2004,

[11] The income level at this bottom twenty percent of household income bracket was $18,900 at the time of the survey. Federal Reserve 2004 Survey of Consumer Finance.
[12] Federal Reserve 2004 Survey of Consumer Finances.
[13] Demos, "Generation Debt: Student Loans, Credit Cards, and Their Consequences," Winter 2007.

more than three quarters of undergraduate students started the school year with a credit card, and only 21 percent of college students pay off their entire balance each month.[14]

Banks and Credit Card Lending

The role of commercial banks in credit card lending has become much more significant over the last three decades. In 1970, although 51 percent of households had a credit card of some type, only 16 percent of households had a bank-issued credit card.[15] Today, 95 percent of households that have some type of credit card hold at least one issued by a bank.[16] As of the first quarter of 2007, FDIC-insured institutions held on their balance sheets $346 billion in credit card loans outstanding, which represented about 5 percent of the banking industry's total loans.[17]

An additional $368 billion in credit card receivables were securitized by FDIC-insured commercial banks and state-chartered savings banks.[18] Over the last 10 years, financial institutions that issue credit cards have securitized approximately half of credit

[14] Nellie Mae, "Undergraduate Students and Credit Cards in 2004: An Analysis of Usage Rates and Trends," May 2005.
[15] Board of Governors of the Federal Reserve System, "Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency," June 2006.
[16] Bucks, Brian K., Kennickell, Arthur B., and Moore, Kevin B., "Recent Changes in US Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," Federal Reserve Bulletin, 2006.
[17] Bank Reports of Condition and Income and Thrift Financial Reports. To avoid double counting, the total excludes approximately $8.6 billion in balances held by banks that are subsidiaries of other reporting institutions.
[18] Total amount of credit card receivables securitized by all FDIC-insured institutions is likely to be greater than this figure. FDIC-insured thrifts that file Thrift Financial Reports do not regularly report the amount of loans that are securitized. As of the first quarter of 2007, there were 135 insured thrifts that had credit card loans on their balance sheets totaling $42.4 billion.

card receivables. In the first quarter of 2007, about half of all revolving consumer credit outstanding was held by pools of securitized assets.[19]

From the perspective of many financial institutions, credit card lending has been an important and generally profitable line of business. While charge-offs have been consistently higher among the 27 institutions the FDIC has identified as credit card lending specialists[20] than for other types of specialty banks or for the banking industry overall, profits have also been higher. Credit card lenders had a return on assets of 3.70 percent in the first quarter of 2007, while the banking industry overall had a return on assets of 1.21 percent. In the first quarter of 2007, the ratio of noninterest income (which includes fee income) to average assets was 9.61 percent for credit card specialists, versus 2.09 percent for all insured banks and thrifts.

Applicable Laws and Regulations

Two key federal statutes that govern lender credit card practices and protect consumers in the use of credit cards are the Truth in Lending Act (TILA)[21] and the Federal Trade Commission Act (FTC Act).[22]

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[19] Federal Reserve Statistical Release G.19 Consumer Credit. Data not seasonally adjusted.
[20] Institutions that exhibit both of the following characteristics are considered to be a specialized credit card lender: (1) credit card loans plus securitized and sold credit cards divided by total loans plus securitized and sold credit cards exceed 50%, and (2) total loans plus securitized and sold credit cards divided by total assets plus securitized and sold credit cards exceed 50%.
[21] 15 USC 1601, et seq.
[22] 15 USC 45.

Truth in Lending Act

The primary statute and regulation affecting credit card lending are TILA, enacted in 1968, and its implementing regulation, the Federal Reserve Board's Regulation Z. TILA is mainly a disclosure statute that requires creditors to provide consumers with the cost and terms of credit so that consumers can compare credit offers and thereby choose the credit card that best suits their needs.

While much of the emphasis is on disclosure, TILA and Regulation Z also provide important consumer protections regarding prompt crediting of payments, treatment of credit balances, and protections to cardholders -- including limits on consumer liability for unauthorized or unlawful credit card use and the right of a cardholder to assert claims or defenses against a credit card issuer. Provisions also address billing resolution procedures, requiring credit card issuers to respond to certain credit card billing errors within a specified period.

The Federal Reserve Board has exclusive authority to promulgate regulations to implement TILA. While they lack rulemaking authority, other Federal banking agencies enforce compliance by their supervised institutions of TILA and Regulation Z, and use their enforcement authority pursuant to section 8 of the Federal Deposit Insurance Act (FDI Act) to address violations.

On May 23, 2007, the Federal Reserve Board proposed amendments to Regulation Z.[23] The notice of proposed rulemaking on Regulation Z contains significant advances in credit card disclosures. The proposed amendments would require important changes to the format, timing, and content requirements in documents provided to consumers throughout the life of a credit card account, including changes in solicitations, applications, account opening documents, change-in-term notices, and periodic billing statements. These proposed amendments will assist consumers in better understanding key terms of their credit card agreements such as fees, effective interest rates, and the reasons penalty rates might be applied, such as for paying late. In addition, the Federal Reserve's proposal would increase, from 15 to 45 days, the advance notice given before a changed term can be imposed on consumers, to better allow consumers to obtain alternative financing or change their account usage.

Federal Trade Commission Act

Credit card issuers are subject as well to the FTC Act prohibition against unfair and deceptive acts and practices (UDAP). The UDAP prohibition applies to every stage and activity of credit card lending, including product development, marketing, servicing, collections and the termination of the customer relationship.

[23] See http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm

Under the FTC Act,[24] an "unfair" practice is one that: (1) causes or is likely to cause substantial injury to consumers; (2) cannot be reasonably avoided by consumers; and (3) is not outweighed by countervailing benefits to consumers or to competition. Situations that meet the statutory definition of unfair are less common than situations that are deceptive.

A "deceptive" practice occurs when a consumer is either misled or is likely to be misled on a material issue.[25] An issue is material if it is likely to affect a consumer's decision regarding a product or service. Notably, omitting information may be deceptive if disclosure of the omitted information is necessary to prevent a consumer from being misled. In determining whether an act or practice is misleading, the FDIC considers whether a consumer's interpretation is reasonable in light of the claims made.

The Federal Trade Commission is primarily responsible for the application and enforcement of the FTC Act. The FTC does not, however, have rulemaking or enforcement authority over banks, thrift institutions, or credit unions. The Federal Reserve Board has the authority to promulgate regulations defining unfair and deceptive acts or practices of banks, while the Office of Thrift Supervision and the National Credit Union Administration enjoy similar rulemaking authority for thrift institutions and credit unions, respectively. Other Federal banking agencies, including the FDIC, may use their

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[24] See 15 USC §45(n).

[25] The definition of deception has been developed through policy guidance issued first by the Federal Trade Commission, see FTC Policy Statement on Deception, October 14, 1983, and later by the banking agencies, see, e.g., "Abusive Practices" section of FDIC Compliance Handbook, http://www.fdic.gov/regulations/compliance/handbook/html/chapt07.html#Federal.

enforcement authority pursuant to the FDI Act to address unfair and deceptive acts and practices engaged in by their supervised institutions, but they have no rulemaking authority.

The FDIC has taken a number of steps to ensure that the state chartered banks we supervise understand how the FTC Act relates to their activities. Nearly five years ago, the FDIC confirmed that the FTC Act prohibition against unfair or deceptive practices applies to the activities of state chartered banks. [26] Together with the Federal Reserve Board, the FDIC issued more detailed FTC Act guidance applicable to all state chartered banks three years ago.[27] This guidance explained the standards used to assess whether an act or practice is unfair or deceptive, as well as the interplay between the FTC Act and other consumer protection statutes. It also offered suggestions for managing risks related to unfair and deceptive practices. Two years ago, the FDIC issued procedural guidance to its examiners to ensure that they have the tools to identify whether unfairness or deception has occurred in a credit card portfolio.[28]

Credit Card Supervision

As of March 31, 2007, the top ten insured bank issuers of credit cards had reported credit card receivables outstanding of $662 billion, or nearly 93 percent of all institutions' reported credit card receivables, and the top three issuers controlled just over 65 percent of the institutions' reported receivables. The FDIC is the primary federal

[26] See FIL-57-2002, issued on May 30, 2002.
[27] See FIL-26-2004, "Unfair or Deceptive Practices by State Chartered Banks," issued on March 11, 2004.
[28] See "Abusive Practices" section of FDIC Compliance Examination Handbook, published on the FDIC website at: http://www.fdic.gov/regulations/compliance/handbook/manual%20389.pdf .

regulator for just two organizations in the top ten: Discover Financial Services, which has a market share of approximately 6.4 percent; and American Express Centurion Bank, which has about 5.7 percent.[29]

The FDIC also supervises a number of smaller credit card issuers. As of the first quarter of 2007, 1,091 FDIC-supervised institutions reported credit card loan portfolios. As a percentage of total loans, credit card loans ranged from less than 1 percent to 100 percent of these banks' respective loan portfolios. FDIC-supervised banks have $104 billion of reported credit card receivables, or about 15 percent of the total for all banks. Of that total, $78 billion are at the FDIC-supervised institutions of Discover and American Express. Excluding those two, FDIC-supervised institutions have $26 billion of reported credit card receivables, or about 4 percent of the total for all banks. The total for all FDIC-insured institutions was $713.4 billion as of March 31, 2007.

Examinations

Bank credit card practices are examined as part of both the safety and soundness examination and the compliance examination. In September 2005, the FDIC implemented a Relationship Manager program that emphasizes a comprehensive and coordinated approach among compliance, safety and soundness, and specialty examination areas in the assessment of the institution's risk profile and capitalizes on

[29] Bank Reports of Condition and Income and Thrift Financial Reports. Outstanding receivables include balances held on balance sheet plus credit card receivables securitized and sold. Totals include all subsidiary institutions in an organization, except for subsidiaries of other reporting financial institutions that would result in double counting. As noted previously, Thrift Financial Report filers do not regularly report amounts of securitized credit card loans.

information sharing whenever possible. Although separate Compliance/CRA examination cycles and reports have continued, the adequacy of the bank's compliance management program is considered in the overall assessment of the bank's management team for safety and soundness as well.

This coordinated approach is especially important in supervising credit card banks, where safety and soundness and consumer protection issues overlap considerably. Practices that violate consumer protection laws or otherwise harm consumers often have the effect of impairing the performance of credit card portfolios, thus affecting the financial condition of these institutions.

Safety and Soundness Examinations

Under the safety and soundness examination program, the overall focus is largely on asset quality, capital adequacy, and earnings. The analysis of operating policies and procedures is key to the examination of credit card banks and credit card operations. Since credit card lending is typically characterized by a high volume of accounts, homogeneous loan pools, and small-dollar balances, the review of individual accounts is not practical. Instead, examination procedures tend to focus on evaluating policies, procedures, and internal controls. The goal of the examination is not confined to identifying current portfolio problems, but also includes an investigation of potential problems that may result from ineffective policies, unfavorable trends, lending concentrations, or nonadherence to policies.

In recent years, safety and soundness examiners have focused their efforts on monitoring compliance with the Account Management and Loss Allowance Guidance for Credit Card Lending (Account Management Guidance) issued on January 8, 2003. The Account Management Guidance was issued by the federal banking agencies in response to observed instances of inappropriate account management, risk management and loss allowance practices. This guidance clarified that the agencies expect lenders to require minimum payments that will amortize the current balance over a reasonable period of time. The guidance also clarified documentation expectations for line increase programs, clarified expectations for over-limit practices, and revised the repayment period for workout accounts.

Compliance Examinations and Complaint Resolution

The compliance examination program is based on a broad range of laws and regulations. The goal is to assess how well a financial institution manages compliance with federal consumer protection laws and regulations.

A review of consumer complaints is part of the pre-exam process for every compliance examination. Complaints about particular practices indicate areas to target for review, either because there may be a breakdown in compliance with specific regulatory requirements or because there may be a broader problem with unfair or deceptive practices.

As the primary Federal regulator of state chartered non-member banks, consumers can contact the FDIC directly with their complaints. Every complaint is tracked and investigated with the issuing bank. How a bank handles and responds to complaints is a key component of a well-managed compliance program.

As shown in the table below, the FDIC receives a substantial number of complaints that relate to credit cards.

	2002	2003	2004	2005	2006	Total
All complaints received about FDIC-supervised banks	4,008	4,057	3,950	3,618	3,831	19,464
Complaints received about credit card issues for FDIC-supervised banks	2,184	2,073	1,608	1,241	1,318	8,424
Credit card complaints as a percent of total complaints received for FDIC-supervised banks	54%	51%	41%	34%	34%	43%

The large percentage of credit card complaints is related, at least in part, to the sheer volume of credit card transactions. As explained above, 75 percent of households have some type of credit card. In fact, many consumers have multiple credit cards that they use multiple times a month.

Questionable Credit Card Practices

A September 2006 report by the Government Accountability Office (GAO) identified practices that raise supervisory and consumer protection concerns even though they may not violate existing law when they are disclosed adequately for consumers to avoid them. These practices include:

- Double-cycle billing: The cardholder, with no previous balance, fails to pay the entire balance of new purchases by the due date and the issuer computes interest on the original balance that had previously been subject to an interest free period.[30] This can materially increase the cost of credit for consumers who have paid a large amount of their debt in the previous month.

- Universal default: The issuer increases rates when cardholders fail to make payments to other creditors or have an overall decline in their credit score. As a result, a cardholder who repays an issuer on time may be assessed a higher interest rate because the cardholder made a late payment to another creditor, or has incurred a significant amount of additional debt. Employing this practice may materially worsen a customer's financial condition and ultimately impair repayment ability on all of the customer's accounts.

- Payment allocation: In this practice, varying interest rates are tied to account usage, but issuer applies payments first to the portion of the account with the lowest rate. As a result, balances on different tiers may shrink or grow disproportionately as payments are made by a customer.

- Minimum payments: The issuer fails to provide for reasonable amortization in setting the required monthly minimum payment and negative amortization results. With large card issuers offering dozens or even hundreds of different card lines, each of which has tiered minimum payment requirements tied to a variety of factors (such as the amount of the current balance and whether that balance is over the credit limit), too low a minimum payment requirement can result in negative amortization for some cards.

- Inconsistent and punitive billing practices: The issuer uses a variety of strategies to raise rates when cardholders make late payments or incur charges beyond their credit limits.[31] Some issuers impose these higher "default" rates

[30] See GAO Report at p. 28, Figure 6, "How the Double Cycle Billing Method Works".
[31] See GAO report at pp. 24 – 27.

> after one late payment or overlimit charge while others use default rates only after a cardholder has made six late payments.

The FDIC is currently reviewing to what extent concerns relating to practices such as double-cycle billing, universal default, excessive fees and penalties, and payment allocation, should be addressed through supervisory action, rulemaking based on safety and soundness authority, or whether rulemaking under UDAP may be required.

At the same time, the GAO Report found that credit card disclosures, "...were too complicated for many consumers to understand."[32] Moreover, while TILA and Regulation Z require creditors to explain some pricing terms in a tabular format, questions have been raised about whether the format is being used effectively to provide information to consumers.[33] Recent research indicates that while consumers pay attention to interest rates when shopping for a new credit card, they do not give much consideration to the ways in which those rates will change if they make a late payment or incur charges over their credit limits.[34]

As noted above, the Federal Reserve recently proposed amendments to Regulation Z. These amendments are intended to improve the quality of credit card disclosures rather than to prohibit any of the practices questioned in the GAO Report.[35] While improving existing disclosures is an important and positive step, the FDIC remains

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[32] Id. at p. 6.
[33] See GAO Report at p. 40.
[34] See GAO Report at p. 31.
[35] See May 23, 2007 release announcing amendments to Regulation Z, published at http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm

concerned about whether information can be provided in an effective way to mitigate the effect of practices noted above.

Subprime Credit Cards

While the practices in the prime card market described above have raised concerns, additional and more egregious practices often exist in the subprime credit card market. This is of particular concern since, as noted above, recent growth in credit card ownership and usage has been especially significant among lower income households. A substantial portion of this growth has been achieved by marketing cards to subprime borrowers, those individuals either with little or no credit history or who exhibit more than a normal risk of loss. Examinations of banks with credit card portfolios, particularly ones with subprime portfolios, have revealed a variety of consumer protection issues. These include inadequate or deceptive marketing and account disclosures, as well as credit products that have little or no credit availability left following the assessment of opening and other fees. Other programs include features and requirements that produce frequent and excessive fees and penalties that result in a debt spiral, along with abusive collection practices.

For example, in one case a bank advertised a credit card with no application or annual fees. However, consumers who received a credit card were charged a "refundable acceptance fee" that completely exhausted the available credit line. According to the card terms, the fee would be "refunded" in increments of $50 every three months, assuming that the consumer made a monthly minimum payment. In addition, the bank

charged a monthly maintenance fee of $10, along with interest at a rate of 20 percent against the outstanding balance. Account activity reports showed few purchases or charges on the accounts; the primary activity comprised the assessment of monthly fees, interest and other charges. The FDIC determined that the card program was in violation of the FTC Act, as the fees associated with the program made any benefit negligible, and the program was structured so that only a very small percentage of consumers would receive any meaningful credit.[36]

In another case, a bank sent out billing statements to delinquent account holders with a prominent message that payment of a specific amount would allow them to avoid certain fees and further collection efforts. However, the amount stated in the message was only the amount past due, not the larger minimum payment, and payment of only the past due amount would leave the account in a delinquent status and result in additional charges. Although the minimum amount due was stated elsewhere on the billing statement, the bank's practice was deceptive because the prominent message directed the consumer's attention away from the correct minimum payment amount necessary to restore the account to a current status. The FDIC determined that this practice violated the FTC Act and took supervisory action.

[36] The recently proposed amendments to Regulation Z will require credit card companies to inform customers if the initial fees or security deposits exceed 25% of the initial credit limit. (See proposed 12 CFR section 226.5a(b)(16); see also Appendix G-10(c)) If these provisions had been in effect at the time that the bank had advertised the card described above, additional disclosures would have been required. However, depending on the facts, the program might still have been carried out in an unfair or deceptive manner.

FDIC Response to Questionable Practices

The FDIC uses its examination program to continually monitor and address issues in the credit card industry and the banks we supervise. Credit card examiners are highly trained specialists who use the full complement of supervisory and enforcement tools at the FDIC's disposal to take action when they find practices that violate the FTC Act, TILA, other consumer protection regulations, or safety and soundness principles. As described above, this includes taking action where practices are unfair or deceptive.

Generally, when problems or violations are identified to bank management, they are corrected as part of the examination process without the need for enforcement action.[37] However, when the problem is especially significant or bank management lacks the willingness or ability to correct inappropriate practices, enforcement action becomes necessary. The FDIC has various formal and informal enforcement tools which are utilized to prescribe recommended courses of action to address practices, conditions, or violations that could result in risk of harm to consumers or loss or damage to a financial institution.

Formal actions are notices or orders issued by the FDIC against financial institutions and/or individual respondents pursuant to section 8 of the Federal Deposit Insurance Act. The purpose of formal actions is to correct noted safety and soundness deficiencies, ensure compliance with Federal and state banking laws, assess civil money

[37] For credit card lenders, the most common violations of law involve lack of compliance with TILA or the FTC Act.

penalties, and/or pursue removal and prohibition proceedings. Formal actions are legally enforceable, and final orders are available to the public after issuance.

Informal actions are voluntary commitments made by an insured financial institution's board of directors. Such actions are designed to correct less serious safety and soundness deficiencies or violations where it is believed that management has both the willingness and ability to effect correction. Informal actions are not legally enforceable and are not available to the public.

To determine the volume of enforcement activity involving FDIC-supervised credit card banks, records of the eleven FDIC-supervised banks designated as credit card lending specialists and of the five banks with the most credit card complaints filed with the FDIC were reviewed. Between 2002 and 2006, the FDIC issued formal and informal enforcement actions against five of the sixteen banks in this group. These actions addressed practices, conditions, or violations that could result in risk of loss to a financial institution or that could cause significant financial harm to consumers. FDIC enforcement actions against banks with credit card portfolios have required correction of both safety and soundness deficiencies and violations of consumer protection laws, as well as requiring the payment of restitution to consumers harmed by the involved practices. For example, an FDIC examination of a State nonmember bank disclosed that a credit card program offered by the bank violated section 5 of the FTC Act. The bank agreed to a Memorandum of Understanding with the FDIC that required corrections to

disclosures and marketing and required restitution by reversing the acceptance fee, finance charges and monthly participation and late fees.

In many instances, however, troubling practices do not rise to the level of violating law or regulation. Although particular issuers often change their practices in response to supervisory recommendations, such action does not appear to result in industry-wide changes.

Conclusion

Credit card activities, while increasingly concentrated in a handful of very large banks, are generally a significant and complex activity in any bank engaged in the various aspects of this consumer lending business. The FDIC is aware of these complexities and closely monitors credit card lenders under its supervision for adherence to safe and sound business practices as well as consumer protection laws and regulations. However, current industry practices and continual innovation in this business line present significant challenges in maintaining a balance between profitability and the principles of consumer protection and fairness. The FDIC is currently reviewing to what extent concerns relating to practices such as double-cycle billing, universal default, excessive fees and penalties, and payment allocation, should be addressed through supervisory action, rulemaking based on safety and soundness authority, or whether rulemaking under UDAP may be required.

This concludes my testimony. I will be happy to answer any questions the Subcommittee may have.

Testimony of John P. Carey

Before the Subcommittee on Financial Institutions and Consumer Credit

June 7, 2007

Good morning Chairwoman Maloney, Ranking Member Gillmor, and Members of the Subcommittee. My name is John Carey, and I am the Chief Administrative Officer of Citi Cards. I appreciate the invitation to appear before you today to discuss the credit card business and how we serve our customers. Citi Cards is one of the leading providers of credit cards in the United States, employing 33,000 people in 28 locations across 20 states.

I understand that the Subcommittee's primary focus today is on recent industry and regulatory initiatives in the credit card industry that affect consumers, including, in particular, the Federal Reserve Board's new proposed revisions to Regulation Z. This is an important topic and we welcome the opportunity to discuss our initial reaction to the Fed's new proposal. We also would like to describe what we have been doing at Citi in recent years -- including new initiatives that we have implemented -- to ensure we are providing our customers unparalleled products and services with terms and conditions that are fair and easily understood. We are dedicated to putting our customers first, which is good for them and good for business. We think we do a very good job but are always looking for ways to improve on what we do.

Background

At the outset, I'd like to step back for a moment and provide some useful context on how the credit card business works, how it has changed in the past 20 years, and why we think these changes have served the public.

Credit cards have become an integral part of our nation's economy, providing meaningful benefits to merchants and consumers alike. Merchants of all sizes benefit from the liquidity, security, and efficiency of credit cards. Credit cards enable businesses to sell more, get paid faster, and protect against fraud. They have also made commerce on the Internet possible, enabling merchants to connect with consumers and businesses globally, increasing sales, improving payment reliability and controlling operating costs.

And for consumers, credit cards are a safe and convenient alternative to cash, making everyday purchases more efficient, making it possible to shop online, and facilitating consumers' ability to track and manage their spending. Responsible credit card use is often an individual's first step toward establishing the positive credit record necessary to finance a car, a house, or a small business, or to achieve some other personal financial milestone.

At the same time, to understand how the business of credit cards works, it is important to recognize what is actually going on whenever a person uses his or her credit card. While most people may not think of it this way, the fact is that every time a person uses a credit card to buy something, that consumer is in effect taking out an unsecured loan -- one that is a lot riskier from a lender's perspective than many of the loans consumers use. A credit card loan, after all,

is not backed by any tangible security as are mortgages, auto loans, or home equity lines of credit. Nor is it based on any personal familiarity between a local banker and his or her customer. It is an extension of credit secured only by a customer's promise to repay.

Before the late 1980s, the credit card market was essentially a one-size-fits-all proposition and was far narrower than the market we see today. Customers were typically assessed a $20 annual fee and interest rates were nearly 20% across the board, regardless of the risk profile of any particular customer. In the last 15 years, this model has changed dramatically. Underwriting practices have become more refined, allowing banks both to offer lower priced credit for people with solid credit histories and to extend credit to consumers who were previously underserved or had no access to unsecured credit. Over time, the availability and competitive pricing for credit cards combined with more precise underwriting analytics has led to an expansion of consumer credit across the economic spectrum. Banks are able to open more new accounts, increase existing account credit lines, and offer rewards programs and the like to a broad range of consumers by using these more sophisticated analytical tools.

The capacity to consider risk when making credit available is key to making this system work. Without that ability to differentiate risk, less creditworthy consumers would have fewer appropriate means of accessing credit, relatively risk-free consumers would face a higher cost of credit, and bank

lending strategies would be significantly curtailed. Industry practices need to be considered in this light.

As a general matter, the broad expansion of credit I've referred to -- some call it the democratization of credit -- has been a good thing. Average credit card rates have declined nearly six percentage points compared to the average rates that prevailed in 1990. Overall, credit card debt remains a small portion of household debt. The Federal Reserve has reported that credit card balances as a percentage of total household debt actually *declined* from 3.9 percent in 1995 to 3.0 percent in 2004.

The lending model for credit cards is unique, and the business works on a relatively thin margin. Year after year, we make roughly the same return of $2-2.50 for every $100 we lend, which equates to only about $1 for every $100 of sales charged to our credit cards. And even that margin depends on careful management of several different kinds of risk -- the credit risk involved in whether customers will be able to repay their obligations; the interest rate risk that our own cost of funds may rise more rapidly than expected; general economic risk; the fraud risk when cards fall into the wrong hands and are used illegally; and the operational risk that any business faces when managing complex systems.

Citi's Record of Serving Our Customers

Citi operates in a highly competitive marketplace in which consumers have numerous payment card choices. Customer satisfaction drives our revenues and lost customers are difficult to replace. We constantly work to meet consumer

demand and maintain customer loyalty, because we know that if we don't provide the best products and the best service, our customers will go elsewhere. With this in mind, let me turn to the subject of disclosure and the Fed's new proposal and then touch briefly on some of the steps we have taken in recent years to improve the products and services we offer.

The Fed's New Reg Z Proposal/Understandable Disclosure. Two weeks ago, the Federal Reserve Board issued its long-anticipated proposal to revise Regulation Z, focusing on disclosure and certain other practices. This is a lengthy, comprehensive proposed rule and we will of course study it carefully in the weeks to come as we prepare our detailed comments for submission to the Fed. But let me state up front in no uncertain terms that in the proposal's thrust and sweep and direction, we applaud what the Fed has done and believe it can foster significant improvements for consumers.

The new proposal is aimed at enhancing the clarity of disclosures, improving customer understanding of key credit card terms and conditions, and maximizing transparency. We fully support that approach. Indeed, we have tackled this challenge ourselves in recent years, as I'll describe in a moment, and we welcome a broad regulatory initiative that will move the whole industry in that direction.

The Fed's effort, in effect, brings us back to a core Congressional finding of the Truth in Lending Act – that economic stability would be enhanced and competition among consumer credit providers strengthened by the informed use of credit that results when consumers understand what credit costs. The

proposed changes usefully require that certain information – in a consistent readable format – be provided at each stage of the consumer's interaction with his or her credit card company. These changes would ensure that consumers not only have the opportunity to understand how their credit card works, but that they also can readily compare credit terms available in the marketplace in order to make informed choices. And the changes would ensure that financial services providers are able to compete on a level playing field.

In essence, the new proposed Reg Z changes seek to move credit card disclosures toward the successful model of food labeling, where consumers can get all the information they need in simple, uniform terms that allow them to readily compare one product to another. Consumers should be able to do the same thing in the world of credit cards, relying on the consistent presentation of important information when applying for credit, when opening an account, when receiving their statement or when the terms of the account change. This is the right approach and we strongly support it.

We also appreciate the fact that the Fed engaged in extensive consumer testing to understand the effectiveness of disclosures while preparing its proposed rule. The Fed used this testing to identify the information consumers generally need to make informed choices about the products they choose and how to use those products.

We also support making available opportunities for consumers to learn about credit products through such resources as the Fed website and the American Bankers Association ("ABA") proposal for a government-issued Guide

to Credit Cards. As the ABA has said, a supplement beyond what can be reasonably included in short, simple disclosures could be quite valuable to consumers and should be made widely and readily available.

In all, we believe that the Fed's proposal will be good for consumers and will be good for ensuring a competitive marketplace where banks compete on quality, service, and value.

Our own efforts to make credit card disclosures clear and understandable are entirely consistent with the approach taken by the Fed. Indeed, all of the effective and simpler to read disclosures cited by the Government Accountability Office ("GAO") in its September 2006 report on credit cards were Citi disclosures.

Our work in this area intensified in early 2005, following a public call from the Office of the Comptroller of the Currency for improved credit card disclosures. Citi was among the first card issuers to revise its solicitation letters, promotional materials, and cardmember agreements to disclose prominently the important pricing terms in the product.

We also introduced an enhanced "*Facts About Rates and Fees*" table in our cardmember agreements, summarizing all rates and fees in clear, easier to read language – similar to what the Fed is now proposing. At the same time, Citi introduced a more consumer-friendly notice to better inform each customer of a change in terms and the right each customer may have to opt out of that change. And we also enhanced our "responsible lender" disclosures by adding a simple paragraph to the front page of all solicitation letters making clear, among other things, any balance transfer fee, the circumstances under which a customer may

lose a promotional rate, and the balances to which the promotional rate does and does not apply. All of these efforts are embodied in the Fed proposal.

Earlier this year, we began developing a new, simplified "Schumer Box," reduced from a 9th grade to 7th grade reading level and a new card agreement reduced from an 11th grade to 8th grade reading level. We intend to proceed with these changes rather than wait for Reg Z to be finalized because we believe they will enhance now the ability of our customers to understand the terms of their cards.

We are also in the midst of rolling out a major redesign of our customer statements. We are currently using the redesigned statement with some two million of our customers and are working with them to understand how we might continue to improve the statements. Some key features of the current new statement include color printing, clarified purchase section, enhanced display of rewards information, improved display of statement messages, prominent messaging for checks, laser high-quality charts/graphs/photographs, more flexibility with varying typefaces and type treatments, and increased point size.

We believe that the more people understand the world of credit, the better off both the providers and consumers of credit will be. Our own new book on credit education and financial literacy, entitled: *The Citi Commonsense Money Guide for Real People* underscores this connection. In our view, a transparent marketplace is not only customer friendly, it is business friendly. We want consumers to understand clearly what we're offering and what our competitors are offering so that they can make informed choices. We are confident that if we

can compete on quality, service, and value, it will be good for customers and good for Citi.

But improving disclosures isn't the end of the discussion. Citi also has taken a number of steps to improve the products and services we offer our customers that we hope other issuers will adopt as well.

Elimination of Repricing Based on Non-Citi Behavior. First, Citi Cards was one of the first issuers to eliminate re-pricing for what we call "off-us" behavior, known by some as "universal default." It is standard practice for credit card issuers to consider a customer's credit behavior with other financial commitments to other creditors and to increase the customer's interest rate if warranted by such behavior. That is not an illogical practice, since a customer's credit behavior elsewhere has proven to be predictive of their behavior with us. Still, we recognized why customers, and others, would question the practice. So two years ago, we took the step of giving customers advance notice and the right to opt out of any such proposed increase in interest rates, while still maintaining full use of their card until expiration.

In March of this year, we decided to go even further. We eliminated the practice altogether for all customers during the term of their card. Citi will consider increasing a customer's interest rate only on the basis of his or her behavior with us -- when the customer fails to pay on time, goes over the credit limit, or bounces a check. This change will be described in our customer communications by later this summer.

Elimination of "Any Time Any Reason" Repricing. Second, we eliminated what is commonly known as "*any time for any reason*" increases to the rates and fees of our customer accounts. Traditionally, credit card issuers have taken the position that they can increase the rates and fees of a cardholder's account at any time for any reason, for example, to respond to general conditions in the financial markets. But in March, we announced that we are giving up that practice. Once a card is issued, we will not voluntarily increase the rates or fees on the account until the card expires and a new card is issued (generally two years). The interest rate on the card, if linked to the prime rate as is typically the case, would still go up or down as the prime rate moves. But the only reason we would consider increasing the rates or fees before the card expires would be if a cardholder becomes delinquent with Citi, exceeds the credit limit, or pays with a check that bounces. We believe we are the first bank to adopt this policy.

When a credit card expires and a new card is issued we will, as is customary, consider a customer's credit risk and general market conditions in establishing new rates, fees, and terms of the account. If we believe any changes are needed at that time, we will give the customer advance notice and the right to opt out and pay down the loan under the old terms. We implemented the change immediately for both new and existing Citi branded credit card customers. It will be reflected in our customer communications later this summer.

Enhanced Customer Alerts. In recent years, we have seen our customers change the way they prefer to interact with us. They have demanded greater utility online and look for us to provide the tools that allow them to manage all of their account needs through the Internet. This has included viewing their account activity in real time, making payments, changing addresses, requesting statements, and ordering additional cards.

In response to customer expectations, we also have developed a set of online tools that are designed to make it easy for cardholders to avoid late fees and to understand and manage their relationships with us. For example, because pay days vary, our customers can choose the day of the month they would find it most convenient to pay their bills. And they can elect to be notified, in advance, about key dates and information related to their bills when they are approaching their credit limit or a payment due date, for example. These alerts are particularly helpful for people who tend to wait until the last minute to pay their bills. We think this kind of customer is better off interacting with us on the Internet. The program is highly flexible: cardholders can choose which alerts to receive and, for some alerts, how often to get them -- daily, weekly, or monthly. These individualized services exist now but are going to be improved in the months ahead to make sure customers are aware of these opportunities and can use them easily.

Extensive Financial Literacy and Consumer Credit Education. Citi is an industry leader in financial education and literacy and we have put in place numerous programs to encourage and promote responsible borrowing. We

believe it is in the industry's interest to do business with educated consumers who have the ability to pay their bills on time and avoid credit pitfalls.

The centerpiece of our credit education effort is the "*Use Credit Wisely*" program, an online program designed to assist consumers in understanding credit basics, how credit works, budgeting, and how to work through difficult situations such as disability or living on a fixed income. The "*Use Credit Wisely*" program also includes specific information and resources on fraud prevention, identity theft, and legal rights for consumers; a credit education web site in Spanish for Hispanic consumers; and "*Use Credit Wisely for Business*," a site designed specifically for the needs of business owners.

In addition, through the innovative components of our *Credit-ED* program, Citi provides ongoing support and the latest resources through a variety of targeted channels to help students manage their credit and money responsibly. Since its inception in 2000, the *Credit-ED* program has distributed more than five million credit education materials free to students, administrators, and parents. Our *mtvU Card* was acknowledged by the advocacy group *Consumer Action* as the most impressive program for rewarding students based on good grades and responsible credit behavior.

We are proud that Drexel University's LeBow College of Business in Philadelphia, Pennsylvania has incorporated the *Credit-ED* challenge as part of the university's financial education curriculum requirement for freshmen. For students, parents, and campus administrators, *Credit-ED*'s comprehensive credit

education site, *Students.UseCreditWisely.com*, features a number of free interactive tools and information on using credit wisely.

Moreover, in 2004 Citigroup and the Citigroup Foundation made a 10-year, $200 million global commitment to financial education and to date have made donations of nearly $53 million to financial education programs in 68 countries.

Improved Security and Protection. Citi is an industry leader in protecting customers from theft and fraud and in offering immediate and effective help to victims. We pioneered the prevention and detection of credit card fraud and have been in the forefront of researching and discovering new and innovative ways to protect our customer accounts and personal information. Starting in 1989, we offered customers our *Fraud Early Warning* feature, which allows us to screen out and detect potentially fraudulent use of our customers' cards. In 1992, we introduced *the Photocard* to help deter unauthorized use of credit cards, and more recently, we began offering virtual account numbers to enhance the security of internet purchases.

Today, should our card members become victims of identify theft or fraud, we offer the most comprehensive and innovative free service — *Citi Identity Theft Solutions* — to help them. We offer our customers free access to a dedicated team of specialists who immediately assist victims of identity theft and fraud and help prevent victims' accounts and credit status from being adversely affected. Our service streamlines and simplifies the entire process of re-establishing a

victim's identity and credit history – saving the customer significant time, money, and inconvenience – even if the fraud happened on another credit card.

Responsive Customer Service. Finally, we have put in place a number of processes to better understand our customers' concerns and respond to them. We review customer calls to help us identify the principal sources of customer concerns; we survey customers to capture feedback from those who have not reached out to us; and we engage in an ongoing dialogue with consumer advocacy groups. Customers are encouraged to contact us for any reason, and we constantly review and enhance our employees' authority to ensure that they are equipped to take appropriate action for our customers. We ask our employees to give our customers the individualized attention that they deserve, but we also challenge them to propose ideas that will enhance the Citi Card experience for all of our customers.

Available Hardship Assistance. Citi has put in place a number of customer assistance programs to help people in need. We know that keeping up with credit card bills can become difficult in times of sudden illness, job loss, or other catastrophic event. For these temporary hardships, we offer programs that can include full or partial deferments, APRs as low as 0%, and/or suspension of late and over-credit-limit fees for up to 12 months. And we also offer longer-term paydown programs that include fee waivers and reduced interest for five years, with the goal of helping the customer to pay off his balance by the end of the period.

Going Forward

Madam Chairwoman, we are working on a daily basis to enhance the products and services we provide our customers. At Citi, we put our customers first and we know that by doing that they will put us first. We seek always to treat them fairly and communicate with them in a clear and understandable way. Above all, we want to make sure that our customers' Citi Card is a convenience that can make managing their financial affairs as easy and stress free as possible. This job is never finished and we know that there is always room for improvement. I look forward to answering any questions that you may have.



Statement of Bill Caywood
Consumer Operational Risk and Compliance Officer
Bank of America

U.S. House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit
Hearing: "Improving Credit Card Consumer Protection:
Recent Industry & Regulatory Initiatives"
June 7, 2007

Good morning, Chairwoman Maloney, Ranking Member Gillmor, and Members of the Subcommittee. My name is Bill Caywood, and I am the Consumer Operational Risk and Compliance Officer for Bank of America.

Bank of America is one of the world's largest financial services institutions. We provide a full range of financial services to individual consumers, small- and middle-market businesses, large corporations and government entities.

In the retail world, Bank of America serves more than 52 million consumer relationships — nearly half of all U.S. households. We operate more than 5,700 local banking centers and 17,000 ATMs, in 30 states and the District of Columbia. Our Web site, bankofamerica.com, is America's leading financial services Web site and the 14th busiest site overall, including Google, Amazon, Yahoo and eBay. Our site attracts 37% of total online banking customers and 65% of online bill payment customers where Bank of America credit card customers may pay their bill for free. We are also the second largest payment processing provider for small businesses.

Bank of America Credit Card Services is one of the largest issuers of credit cards in the world. We operate in the United States, Canada, Ireland, Spain and the U.K. Our primary business is to make unsecured loans through credit cards. We also process credit card transactions for small businesses and large corporations through our Merchant Services business.

* * * *

I am pleased to have the opportunity to participate in today's hearing on "Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives." I will focus my comments on recent initiatives to improve practices in the credit card sector. First, I will focus on the Federal Reserve Board's proposed revisions to Regulation Z. Next, I will highlight our own efforts to enhance consumer understanding of credit card terms. Third, I will comment on the importance of free competition in the credit card industry. Finally, I will respond to the Committee's questions with respect to subprime lending.

I'd like to note at the outset that Bank of America takes pride in its relationships with its customers. We continually update our practices to respond to changing consumer demand. And we believe that a well informed consumer is fundamental to a competitive market, and our ability to meet customer demand and create innovative products. We have taken numerous steps, which I will describe, to educate consumers about the terms of their credit products, thereby allowing them to obtain the best value and avoid potentially costly choices. But there is a limit to what we can do. We operate in a highly regulated industry. Regulation Z governs the common disclosures among all issuers. These disclosures are necessary to allow effective comparison shopping.

Regulation Z

Background

The Committee has asked us for our views on the Federal Reserve Board's proposal to substantially revise its Regulation Z, which implements the Truth in Lending Act. The Board's proposal was just released, and we expect to file a detailed comment letter before the comment period ends in October. Today, I will outline what we see as some of the major effects of the rule, but I will not attempt to provide comprehensive comments, and ask the Subcommittee to recognize that this analysis is preliminary. The proposed rule would require issuers to redesign: 1) applications and solicitations; 2) disclosures provided to consumers at account-opening and subsequently; 3) periodic billing statements; and 4) on-going advertising materials. This will mean significant reengineering of all related processes and computer systems. In order to provide comprehensive comments, we need to work through the practical effects of making such substantial changes, and that work will take time.

We believe that revisions to Regulation Z are appropriate. Over time, in response to consumer requests, credit cards have become more flexible, feature-laden products. Risk-based pricing now allows more consumers to qualify for credit by varying the price of credit based on individual customer behavior and circumstance. With the increase in flexibility and eligibility, the job of describing how the product works has become increasingly complex and has resulted in a need to update the applicable regulations. Certainly, card agreements were simpler when the product was offered only to wealthier customers who paid an annual fee and were required to repay the balance in full each month, but the current system has democratized access to credit and made the credit card a more useful instrument for more consumers than ever before.

We believe that consumers can readily understand the credit card terms that are of most importance to them. In essence, consumers need to understand: (1) what their standard interest rate will be if they decide to carry a balance on the account; (2) what conduct might cause them to pay a higher interest rate or incur fees, and what those rates or fees are; and (3) certain service fees (such as annual fees or foreign exchange fees) that they may be charged. We believe that the existing disclosures serve this purpose, and that customers use these disclosures effectively when they compare issuers and use their cards.

Overview

Our initial review suggests that the proposed revision to Regulation Z is an improvement on the existing regulation. It will provide customers meaningful disclosures in an even clearer format, and it will facilitate comparison shopping and better assist consumers in modifying their behavior, potentially reducing their cost of credit.

The Board and its staff obviously have devoted considerable thought to the proposal. The vast majority of the proposal explains how and why the Board arrived at the content of those disclosures. We appreciate the fact the Board has explained the research and thinking behind the proposal.

In its proposal, the Board has amended the required account-opening disclosures to provide a tabular summary. While implementing the new format will impose significant costs on Bank of America and other issuers, we believe that the new disclosures will provide consumers relevant information in a clear and more easily understood form.

The Board's proposal also requires a tabular disclosure on the periodic billing statements under specified circumstances. Furthermore, transactions, interest charges and fees will be grouped together in a new way that we think will be more easily understood by customers. Although the reformatting of the periodic statement will result in a significant redesign effort, we believe that the revised statement will quickly and more clearly provide customers relevant information about their accounts, and assist them to better understand the cause of any credit-related fees incurred during the previous cycle and help them to better avoid those fees in the future.

While our overall reaction to the proposal is favorable, the proposed changes to Regulation Z, if finalized, would not be easy to implement and would require issuers to incur considerable time and resources to rewrite the vast majority of communications we make with our customers and to change the ways these communications are delivered. It would also require substantial time to prepare and test, and it will be important for the Board to allow sufficient time for this to occur. Nevertheless, we support what the Board is doing and believe it will, over time, produce even better informed customers.

Although we generally support the changes to Regulation Z, we have identified one area where we believe the proposal can be improved.

45-Day Notice Prior to Default Repricing

Section §226.9(g) of the proposed rule requires an issuer to notify a customer 45 days prior to the effective date of any "Penalty Pricing" – that is, an increased rate of interest based on a customer's violation of the card agreement. The notice states that the goal of this provision is to provide prior notice before a changed term can be imposed and thereby "to better allow consumers to obtain alternative financing or change their account usage." We understand the goal behind the proposal but believe that, as drafted, it risks having the opposite effect.

As a matter of practice, Bank of America currently imposes default repricing only after *two* defaults in a twelve month period. (In our case, a default means going over the credit limit or paying late.) Some of our competitors use one-default repricing. Because the 45 day notice requirement delays the effect of an interest rate increase, we presume that the likely effect of the Board's proposal will be to push more issuers into repricing after a single default. The result will be more customers being repriced, and being repriced sooner, albeit after having received the Board-mandated notice.

This result is readily avoidable through a minor change to the proposal. The Board could allow issuers who reprice only after two (or more) defaults to notify the customer after the first default, as a warning that a future default will result in a higher interest rate. Such a notice should have a greater impact than the initial disclosures, because it would be less hypothetical – as the customer has engaged in conduct that he or she has agreed will trigger, if repeated, a higher rate.

Such a notice would also avoid punishing issuers who choose to give customers a second chance before imposing a higher rate. And, consistent with the purpose of the provision, consumers would be free after receiving this warning to seek alternative financing *or* to change their account usage – in our case, by not making a late payment or going over the credit limit again.

Summary

In summary, our preliminary analysis is that the Board has done a good job of revising Regulation Z. We will use the remaining months of the comment period to determine whether the proposal creates any other potential unintended consequences for consumers, as we believe the 45-day-notice provision could, or produces any unreasonable operational costs to the business. We look forward to providing our comprehensive feedback to the Board.

Bank of America's Credit Card Practices

Some specific credit card practices have been the focus of recent criticism. We believe it is important to reiterate Bank of America's position on these issues:

- Bank of America has never engaged in double-cycle billing.
- Bank of America has never engaged in universal default – that is, automatically repricing a customer, without further notice or consent, based only on the customer's default with another lender.
- Bank of America limits the frequency of risk-based re-pricing by amendment. In addition, when we determine that an account's risk has increased, and proposes a change in terms (an increased rate), the customer can reject the proposed change in terms and pay down their account over time under the existing terms.
- Bank of America limits the number of consecutive over limit fees; we have a hard stop at three.
- Bank of America increasingly allows customers to cure from default pricing to a lower rate if they have no late or over limit events for six consecutive months.
- Bank of America customers can pay their bills free in various ways, including: (1) through the mail, (2) at one of our 5,700 banking centers nationwide (3) by using the voice response unit (VRU) and paying with a Bank of America account or (4) online at bankofamerica.com. We charge a $15 fee for those customers who want to pay by phone through a customer service representative, or through VRU using a non-BAC account. Both methods require exception handling, and we charge a fee for that service.

I am proud to say that we arrived at these policies some time ago by listening to our customers and implementing practices designed to meet their financial needs and concerns.

Bank of America's Customer Education

In fact, it is from listening to our customers that we learned that they have a growing desire for improved information and more control over their finances. That is why we offer easy-to-use tools like Online Banking and Alerts to help our customers manage their accounts responsibly with the greatest flexibility and freedom:

- **Online Banking** allows customers to view information about their credit card and other accounts. Customers can track intraday activity, transfer funds and pay bills any time, anywhere they have Internet access.

- **Alerts** are messages sent to customers' computers, PDAs or mobile phones to inform or protect customers. They can warn the customer when he or she is approaching a credit limit or has an upcoming payment due date. They help combat identity theft. Customers choose the alerts they wish to receive. We have a dozen different alert triggers specific to credit cards. They are either automatic or can be set and/or adjusted by the customer. These free options include triggers like a warning of an account balance approaching a credit limit, an upcoming payment due date, a low balance threshold being reached, the availability of a deposit, etc., as well as a host of ID theft type alerts. The alerts can go by e-mail or text message or both.

We have gone beyond required disclosures to provide customers with brochures that are simple, straightforward and easy to understand. Our brochures like "Credit Cards & You" and "Our Account Fees Explained" describe *in plain language* how credit cards work and how to avoid fees.

- **"Credit Cards & You"** provides clear information about interest rates, grace periods, how cash advances work, how balance transfers are treated, how payments are allocated among outstanding balances, and the importance of paying on time and staying within your credit limit. We started inserting this brochure to new customers in June.

- **"Our Account Fees Explained"** provides clear descriptions of some common account-related charges that could be incurred and explains how they can easily be avoided. This brochure has been available for several years in our banking centers.

To increase awareness of these resources, Bank of America has launched online advertising under the theme, **"A Little Knowledge Is a Powerful Thing,"** to educate consumers about these and other tools to manage their accounts wisely.

In addition, Bank of America believes that financial literacy is best taught early. That is why we sponsor basic money management programs for high school and college students with our partner, Monster.com. For example, we are the only lender partnering with Monster's "Making It Count" division to offer "Ultimate Money Skills," a program that educates college students and their parents on financial products, how to establish a solid credit history and maintain identity theft protection. Between August 2006 and March 2007, we made nearly 240 "Ultimate Money Skills" presentations to more than 13,000 students on college campuses.

Why are we engaged in these financial education efforts for all of our customers? First, our research shows that customers who are empowered with this information are more satisfied. Second, our business does best when our customers manage their credit responsibly. One of the great myths we hear is that credit card companies prefer customers to default on their obligations, so that we can earn higher fees. That is simply not the case. Our average annual net

credit losses on credit card loans for the last two years exceeded by a wide margin our revenue from late and over-limit fees.

While we are proud of these efforts and believe they will be useful to our customers, we note that those efforts are not a substitute for the modernization of Regulation Z. We believe that an improved Regulation Z is the best way to provide consumers the information they need, and that competition will benefit from fully informed consumers.

The Importance of Competition

As noted, we believe that the Board's proposal is an important step forward, and will improve a market that is already highly competitive. We believe that Congress should consider the results of the Board's regulation before taking the extraordinary step of legislating the price and terms of credit.

The credit card industry is intensively competitive, and has produced products that are extraordinarily popular with the millions of customers served by the industry. Prescriptive restrictions of price and terms risk undoing many of the benefits that competition has produced – flexibility in terms, a democratization of credit – by imperiling risk based-pricing and innovation. Such efforts are also notorious for triggering the law of unintended consequences: by regulating one price it forces another higher. Therefore, we respectfully suggest that Congress give the Board's significant effort and a competitive market the opportunity to work before taking more invasive steps.

Subprime

The Committee has asked us to review industry reforms in the subprime market, and to advise it on whether additional information gathering is necessary.

Bank of America's role in the subprime credit card market is very limited. We offer a secured card product for consumers who might not qualify for an unsecured loan. The customer must provide us with funds (either by writing a check or having funds transferred from a Bank of America deposit account) to create the security that we will hold, and the credit line is generally set at the amount of that security deposit. These accounts represent an extremely small part of our portfolio, but we offer them as a way of developing what we hope will be a lasting relationship with a new customer. While we have unique risk-control and pricing strategies that we apply to our secured cards, they generally operate in the same manner as unsecured cards. The goal of the program is to graduate the customer to an unsecured credit card product.

While we have chosen to limit our activity in the subprime credit card market, it is worth noting that Regulation Z applies to all credit card lenders, including subprime lenders. The banking regulators and the FTC also have authority to punish any unfair and deceptive trade practices, and have done so in the past.

Conclusion

Thank you for this opportunity to address the Subcommittee. I would be happy to respond to any questions the Members might have.

For Release Upon Delivery
10:00 a.m., June 7, 2007

TESTIMONY OF

JOHN C. DUGAN

COMPTROLLER OF THE CURRENCY

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

OF THE

U.S. HOUSE OF REPRESENTATIVES

JUNE 7, 2007

Statement Required by 12 U.S.C. § 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

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INTRODUCTION

Chair Maloney, Ranking Member Gillmor, and members of the Subcommittee, I welcome this opportunity to appear before you today to discuss current issues affecting the credit card market. This is a timely opportunity to discuss important concerns that have been raised in the Subcommittee's letter of invitation, as well as other related issues. To do that, my testimony is organized in four parts.

Part I provides an overview of the current credit card market. Before discussing concerns that have been raised about certain current market practices, it is important to provide context on the evolution of credit cards and the range of benefits they provide to consumers today. Given their open-ended nature, credit card accounts require ongoing and prudent risk assessment and management, and credit card issuers use pricing as one important way to balance these risks. Risk-based pricing has become very sophisticated and today allows card issuers to offer credit products with lower rates to consumers with lower risk attributes, and to make available, at higher rates, credit products to consumers with higher risk attributes who previously might not have been able to obtain credit at all. The ability to manage credit risk inherent in credit card lending through appropriate risk-based pricing mechanisms is very important to the soundness of banks' credit card business.

Part II describes the program of the Office of the Comptroller of the Currency (OCC) for supervising the credit card operations of national banks. The OCC has a strong and comprehensive risk-based program for supervision of these operations, which include most, but not all, of the largest credit card issuers in the market today. OCC experts – retail credit, credit card, and compliance specialists – conduct ongoing examination and oversight of credit card

operations at national banks. In addition, the OCC has been a leader in providing supervisory and compliance guidance on key credit card issues, including account management practices, negative amortization, universal default, and re-pricing disclosure issues; in our consumer complaint analysis and resolution function; and in our enforcement actions to reform unlawful credit card practices.

Given the longstanding and primary role of disclosures in the regulation of consumer credit under federal law, Part III discusses the need for better and more effective credit card disclosures, particularly in the context of certain credit card practices that have been the focus of public complaints recently, such as universal default, unilateral change-in-terms provisions, and double-cycle billing. Effective disclosure provides three important consumer benefits: informed consumer choice; healthy card issuer competition to provide consumers the terms they want; and increased transparency that makes it more difficult for issuers to withstand public criticism of practices that are especially aggressive. But, consumer disclosures for credit cards have not kept pace with significant changes in the market over the past decade or so that have affected credit card terms, practices, and pricing structures. The Government Accountability Office (GAO) recently studied this area and has called for comprehensive reform of credit card disclosure rules. In this regard, the Federal Reserve Board has recently proposed very substantial revisions to its disclosure regulations for credit cards under the Truth in Lending Act (TILA). My statement describes our preliminary reaction to the Board's proposal. In a nutshell, we are both encouraged and pleased that it appears to be responsive to a number of the recommendations we previously made in a formal comment letter to the Board, particularly with respect to the importance of employing consumer testing to develop effective consumer disclosures, and the use of standardized and simplified disclosure formats. Nevertheless, based on our considerable

experience in supervising credit card operations, we are likely to suggest improvements to the proposal after we study it more carefully.

Finally, Part IV provides some brief concluding remarks regarding our thoughts on the potential benefits of an updated disclosure regime and whether it will be adequate to address concerns raised about current practices. It also addresses the need for uniform approaches when addressing all these concerns, and it notes the challenges we face in seeking to modify specific market practices today when those practices are not generally restricted by current federal law or regulations.

I. BACKGROUND/EVOLUTION OF THE CREDIT CARD MARKET

Credit cards are ubiquitous in our society, with almost three-fourths of American households owning and using a credit card. Credit cards also are one of the most convenient, and commonly used, payment vehicles today. There are a number of consumer benefits to owning a credit card, including the security and convenience of not having to carry cash, the ability and ease of making payments for on-line purchases, and the ability to spread out payments for purchases over time.

Indeed, because of their convenience, security, and widespread acceptability, credit cards are used for billions of consumer purchases every year.[1] The GAO reports that, in 2005, there were more than 691 million credit cards in the market used for consumer transactions, and the value of these transactions exceeded $1.8 trillion.[2] Bank-issued credit cards are by far the

[1] The Nilson Report, February 2004, Number 805, pp. 6-9.
[2] "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," U.S. Government Accountability Office, September 2006, (GAO Report), p. 9.

predominant type of credit card, accounting for over 80 percent of the cards in the market.[3] Although more than 6,000 institutions issue credit cards, accounts are now concentrated among the ten largest issuers.[4] Together, these issuers hold 90 percent of the total market, with outstanding balances in excess of $700 billion.[5]

The evolution of the credit card market has been a remarkable development – from a novelty in the early 1960s available just to a small number of individuals, to an essential payment device today that offers convenient and instant access to credit to hundreds of millions of consumers, almost anywhere at almost any time. More than 40 percent of existing cardholders use their credit cards as a free means of access to the electronic payments system. These consumers pay no interest or other finance charges on their transactions because they pay their credit card balances in full each month. In the words of the GAO, convenience users "avail[ ] themselves of the benefits of their cards without incurring any direct expenses."[6]

Like other consumer credit markets, the credit card market is highly competitive, and growth is a key market objective. Card issuers have responded aggressively to increasing market competition, with innovations in card products, marketing strategies, underwriting, account management practices, and pricing strategies. The primary goals of these product and marketing innovations have been the establishment of new customer relationships and related revenue growth, issuer efficiency, and consumer convenience. In this market, credit card issuers are competitively disadvantaged when they are subject to regulatory costs that are not imposed uniformly on all issuers.

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[3] "Recent Changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, *Federal Reserve Bulletin* 2006, p. A31.
[4] GAO Report, p. 10.
[5] CardFlash, May 8, 2007, p. 2.
[6] GAO Report, p. 32.

Competition for customers has also led to greater credit availability through greater product and pricing choice. Over the years, consumers have been able to choose and obtain credit cards much more easily from different issuers, and certain simplified disclosures such as the so-called "Schumer box" have enabled consumers to better compare key features of credit cards. As a result, although pricing structures have evolved and become more complex, competition in recent years has led to generally lower interest rates and the elimination of most annual fees. It has also made it easy for consumers to transfer card balances to a new card and obtain more favorable terms, including temporary zero percent interest rates on transferred balances. In fact, given the maturity of the credit card market and the relatively finite number of potential new customers, the fiercest competition among card issuers appears to be in the area of balance transfers, where consumers move from one lender to another.

Interest rates on credit cards are higher than most other types of consumer lending because credit card lending is riskier. Credit card loans are unsecured, available to large and diverse segments of the population, and are repayable on flexible terms at the cardholder's convenience. Moreover, unlike closed-end loans that have fixed amounts lent and due, credit card loans are open-ended: the consumer can increase the amount of credit extended at any time up to a specified limit, and issuers generally do not separately underwrite each advance.

These unique features of credit card loans – open-ended, unsecured credit – create a unique set of risks for card issuers. One important tool they use to compensate for these risks is pricing. As noted above, pricing structures for credit cards have evolved and become more complex in recent years. At the same time that average interest rates have declined and annual fees have virtually disappeared, card issuers have adopted risk-based and penalty pricing. They have also imposed a range of fees for such transactions as balance transfers and foreign currency

conversions – although despite this increased use of fees, most credit card revenue continues to be derived from interest charges, including penalty interest charges. Moreover, as noted in the GAO report, the net effect of these changes in pricing structures on card issuer profitability has generally been neutral, with profits remaining relatively stable over time.[7]

II. OCC SUPERVISION OF CREDIT CARD ISSUERS

The OCC has a robust and comprehensive risk-based program for supervising national banks' credit card operations. Our supervision focuses both on compliance with applicable consumer protection standards and safety and soundness. Through our supervision, we can address emerging risks on an institution-by-institution or broader basis and, where necessary, require correction of consumer protection or safety and soundness problems that we may find. There are four primary tools that we use to accomplish these objectives: examinations, complaint analysis, supervisory guidance, and enforcement actions. Each is discussed below.

A. Examinations of Credit Card Operations in National Banks

The OCC conducts thorough examinations of national bank credit card operations. These examinations monitor whether credit card lending complies with applicable consumer protection laws and regulations; is conducted in a safe and sound manner; and is consistent with OCC guidance.

The OCC has a large network of retail credit, credit card, and compliance specialists located throughout United States who have supervisory responsibility for the consumer compliance and safety and soundness aspects of national banks' credit card lending operations.

[7] GAO Report, pp. 69, 75.

The number of our specialists has increased significantly in the past ten years due to the growth, concentration, and increasing complexity of these operations in national banks. These examiners primarily work in the parts of the OCC that focus on supervision of large banks, mid-size banks, and specialized credit card banks.

At the largest national banks, which include many of the major credit card issuers, the OCC has resident, on-site examination teams engaged in continual supervision. At the mid-size and credit card banks, the OCC has staff dedicated to the stand-alone credit card operations. The time and attention that examiners devote to the credit card activities of other banks is directly related to the nature and complexity of the bank's operations and the associated risks. As a result, we provide more scrutiny to high-risk and complex credit card operations, with more frequent examinations than are contemplated by the general 12- to 18- month examination schedule for other banks.

The starting point for a credit card bank's examination generally is an assessment of the bank's risk profile. This assessment identifies particular risks facing the bank, as well as any emerging industry-wide risks, based on information available to the examiners and risk assessments conducted by the bank. The examination process includes a review of fundamentals such as the reasonableness of the bank's credit card business model and strategic planning; the effectiveness of the bank's controls; financial strength; and compliance with laws, regulations, and relevant supervisory guidance. Examiners assess the adequacy of policies and procedures through reviews of various functions including marketing practices, underwriting, account management, collections, and loss mitigation. In addition, examiners review the bank's use of credit scoring and other models, and, as warranted, bring in quantitative analytical specialists to assess model development and validation.

In addition to ongoing monitoring, our large bank resident examiners complete periodic targeted reviews throughout the year. These reviews are used to test and validate the integrity and reliability of management's control processes, including compliance with bank policies and procedures, laws and regulations, and regulatory guidance. In the largest credit card operations, it is common for examiners to complete several targeted reviews within a 12-month cycle.

Targeted reviews typically include a sample of individual accounts to assess the adequacy of the bank's systems, controls, legal compliance, and compliance with OCC regulatory policies or guidance. For example, in the past two years, examiners completed in all large bank and specialized credit card operations targeted reviews of credit card disclosures for compliance with laws, regulations, and OCC guidance, and account level transaction testing in the areas of account management and collections. Other targeted reviews included evaluation of new account underwriting processes and compliance with privacy requirements. If potential consumer compliance issues surface in the course of these examinations or are otherwise brought to examiners' attention through consumer complaints or other sources, examiners and other OCC personnel assess whether the practices in question violate applicable laws and regulations or OCC guidance and standards.

In this context, let me emphasize one very important point: the OCC's supervisory process can result in significant reforms to bank practices and keep banks on a proper course *without the need to resort to formal enforcement actions.* OCC examiners have significant supervisory authority and influence over the activities of national banks. The flow of communication between the bank and OCC examiners is open and continual. The traditional confidentiality of the bank examination process facilitates this free flow of information. Bank management is expected to be open and forthcoming, and examiners expect to get the

information they need to evaluate whether the bank is operating in accordance with applicable law and in a safe and sound manner. Examiners, in turn, are direct and frank in expressing any concerns they have about the bank and in describing any corrective actions they believe are needed.

Indeed, the supervisory process is a continual process of communication between the OCC and the banks we supervise; it does not depend on discrete "compliance" examinations that occur at particular intervals during a multi-year period, nor does it rely in the first instance on formal enforcement actions. OCC supervision results in adjustments, corrections, and remediation on an ongoing basis by national banks. When our examiners identify an issue, they expect it to be resolved in a timely manner. Examiners use a wide range of measures to obtain desired results. These include nonpublic memoranda of understanding as well as communications in a confidential examination report of "matters requiring attention" of bank management and boards of directors. The bank's corrective action in response to these documents is closely monitored by supervisory staff.

The supervisory process can be especially effective in addressing problems early, before they become more widespread. Moreover, because the supervisory process can effect swift change in bank practices without the need to resort to formal enforcement actions, it is a highly valuable tool that is unavailable in "enforcement only" regimes. Because bank supervision involves confidential communications with regulated institutions, however, and because much of the problem identification and corrective measures occur "behind the scenes" and without public fanfare, the process is often not well known or fully understood. While the OCC does not hesitate to bring an enforcement action when appropriate, in practice, the need to do so is relatively infrequent. In the supervisory process of comment and response, banks typically agree

to changes and remediation recommended by examiners and, thus, we are able to address supervisory concerns much more quickly than would be the case if we relied first and foremost on formal enforcement actions.

Based on our supervisory experience, we believe that the vast majority of the credit card issuers supervised by the OCC are complying with consumer protection laws and regulations, are operating in a safe and sound manner, and are striving to balance their business objectives with customer needs. But credit card issuers are not perfect. National bank credit card issuers hold over 300 million credit card accounts. Mistakes can happen. And, as noted earlier, the credit card market is highly competitive, and on occasion, some issuers may adopt aggressive changes to their credit card programs and products, and marketing and account management practices, without fully addressing all of the related risks to consumer protection and safety and soundness or without fully anticipating the potential for systems problems associated with those changes.

The OCC can address many of these issues and achieve corrective action as part of our supervisory process. Indeed, through this process, national banks have changed their practices and provided financial relief to customers to address specific concerns identified by the OCC. These have included revisions to minimum payment requirements; credit line increase and workout programs; over-limit authorization and fee assessment procedures; and the timeliness of posting payments. And of course, as described in more detail below, where the supervisory process by itself is not effective in producing necessary change, the OCC can and will turn to its broad range of formal enforcement tools to achieve the desired result.

There are limits, however, to what can be accomplished through OCC's supervision and enforcement. We have been successful in achieving changes in bank policies and practices

through supervisory actions where such policies and practices fail to comply with consumer protection requirements that the OCC has been charged with implementing, raise safety and soundness risks, or risk violating prudential standards – such as the prohibition on unfair and deceptive practices. Our ability to effect change is more limited, however, if a practice does not put a bank at risk of violating applicable laws and regulations – and in some cases may even be specifically permitted by them (such as double-cycle billing), and does not present safety and soundness risks. And, of course, our supervisory activities cannot direct the practices of credit cards issuers that are not subject to OCC supervision.

B. OCC Consumer Complaint Process

1. *Description of CAG Operations and the Number and Source of Consumer Complaints*

The OCC's Customer Assistance Group (CAG) provides assistance to customers of national banks and their subsidiaries by fielding inquiries and complaints from, or on behalf of, these customers. CAG also supports our supervision of bank credit card operations. Many complaints received by CAG concern credit card products. CAG's complaint processing and analysis often helps to address individual problems and educate consumers about their financial relationships. It also frequently leads to resolution of the complaints by the bank and secures compensation or other relief for customers who may not have a more convenient means for having their grievances addressed.

CAG integrates skilled professionals and effective use of up-to-date technology to address bank customer concerns, and our significant investment in the success of this operation has resulted in its becoming a leader among government complaint analysis and resolution

functions.[8] CAG is staffed by customer assistance specialists who have backgrounds in consumer law, compliance, and bank supervision, and who can process written complaints and telephone calls in both English and Spanish. Additionally, other OCC personnel, including attorneys in the OCC Law Department, regularly assist CAG staff with more complex issues or problems.

CAG processes approximately 70,000 complaints and inquiries each year on a multitude of consumer issues that are received through a variety of channels, including orally and in writing. Many of the complaints are received directly from consumers. But there are numerous other sources as well, including Congress, federal agencies, state attorneys general, state banking departments, or other state agencies. For instance, CAG receives thousands of complaints each year in referrals from state entities.

In this regard, I am very pleased about the significant progress we have made in working with our state counterparts to improve consumer complaint information sharing. A few months ago, the OCC and the Conference of State Bank Supervisors (CSBS) agreed on a model Memorandum of Understanding (MOU) that is intended to facilitate the sharing of customer complaints. The MOU provides that we will direct complaints to the appropriate agency – for example, complaints about non-national bank companies will be directed by the OCC to the appropriate state regulator, and state agencies will refer national bank complaints to CAG. In addition, the MOU permits state agencies to obtain periodic reports from us on the disposition of complaints they have referred to CAG, without compromising consumer privacy.

[8] *See* "Remarks by John C. Dugan before the Exchequer Club and Women in Housing and Finance," (January 17, 2007) (discussing the sophisticated systems used by CAG in connection with the complaint resolution process), www.occ.gov/ftp/release/2007-4a.pdf.

With the assistance of CSBS, we are in the process of entering into complaint information sharing agreements with individual states, and the process is moving along very well. We have executed 18 agreements since November, beginning with the New York State Banking Department, and others are on the horizon. I am also very encouraged by the progress of work that we have underway to put in place new technology systems to facilitate complaint information sharing and route consumers to the appropriate state or federal regulator to assist in resolution of their complaints.

2. *Credit Card Complaints and CAG's Role in Assisting Consumers*

In each of the last few years, credit card issues accounted for approximately 40 percent of the total complaints and inquiries received by CAG. Roughly 10,000 written complaints out of a total of 27,000 received by CAG in 2006 concerned credit cards. Almost 14 percent of the complaints about credit cards we received in 2006 concerned changes to existing account terms. About seven percent of credit-card related complaints concerned fees and other charges, such as the amount of over-limit and late payment fees, late fees assessed in error, allegations of "bait and switch" tactics in connection with fee increases, and the adequacy of fee disclosures. Less than one percent of credit card complaints concerned allocation of payments issues – generally in connection with balance transfer situations. The remaining credit card complaints dealt with a variety of issues, including periodic statements, advertisements and solicitations, and credit balances.

When CAG receives a signed written complaint, it contacts the national bank involved and requests a response regarding the consumer's complaint or inquiry and, if relevant, supporting documentation. CAG evaluates the bank's response, consults with other OCC

personnel, requests additional information from the bank or consumer as necessary, reaches a final conclusion regarding the matter, and notifies the consumer or other complainant of its findings.

Over the last five years, CAG has generated almost $9.5 million in financial relief for national bank customers with complaints about their credit cards. CAG cannot always provide the relief requested by the consumer, however. In some instances, the consumer's complaint may hinge on the resolution of factual disputes, which the OCC simply is not in a position to adjudicate. In other cases, the basis for the consumer's grievance is that he or she is simply unhappy with the terms of his or her contract with the credit card issuing bank. This can include contract provisions governing the amount of fees, changes to the terms, and balance calculation methods.

3. *Impact of Consumer Complaint Information on Bank Supervisory Activities*

In addition to providing relief and assistance to individual consumers, data derived from the CAG process plays an important role in identifying problems – at a particular bank or in a particular segment of the industry – that warrant further investigation by examination teams, enforcement action, or supervisory guidance to address emerging problems.

OCC supervisory guidance requires examiners to consider consumer complaint information when assessing a bank's overall compliance risk and ratings, and when scoping and conducting examinations. The complaint data collected by CAG are summarized and distributed to OCC examiners to help them identify issues that warrant further review. Examiners have nearly real-time access to an electronic database that stores consumer complaints and other relevant data for use in bank examinations. Examiners may use this information in assessing

risks at the banks they examine, as well as in planning and scoping examinations to target areas of potential concerns. CAG specifically alerts examiners if the volume, patterns, or types of complaints concerning a particular bank appear to warrant immediate attention. When complaints indicate potentially inappropriate or unfair or deceptive practices, OCC lawyers become involved, and we have taken enforcement actions to address these issues. Moreover, as discussed more fully below, an important component of OCC supervision is the guidance we issue to alert national banks to emerging risk areas. CAG information also informs OCC policy personnel on the need for additional supervisory guidance, such as guidance related to credit card marketing practices.

Finally, OCC guidance requires national banks to monitor and address consumer complaints that they receive, whether from consumers directly or through CAG. To encourage banks to address the underlying factors that may be contributing to consumer complaints, CAG provides aggregate feedback to banks on credit card practices that, based on complaint volume received, need improvement. CAG is in contact with banks with large complaint volumes regularly, through telephone and email exchanges, and through annual meetings with bank management.

C. OCC Supervisory Guidance

The OCC does not have legal authority to issue regulations under the primary consumer protection statutes governing credit card activities; instead, such authority is vested in the Federal Reserve Board. Nevertheless, an integral component of OCC supervisory activities is the issuance of guidance to national banks on emerging and significant risks. We use joint agency issuances and OCC guidance to explain regulatory requirements. In areas where regulations

have not kept pace with the changes and complexities in credit cards terms and marketing practices, we also have used OCC guidance to alert national banks to practices that pose consumer protection or safety and soundness risks, and to give guidance on how to manage these risks and prevent problems from arising. And, the OCC follows up through the supervisory process to assess national banks' implementation of the recommendations contained in our guidance.

The OCC has been actively engaged in developing supervisory guidance on credit card issues, and this guidance has led to real improvements in credit card practices.[9] For example, we have issued a number of supervisory guidance documents over the last five years, including:

- OCC Bulletin 2003-1, Credit Card Lending: Account Management and Loss Allowance Guidance (January 2003)
- OCC Advisory Letter 2004-10, Credit Card Practices (September 2004)
- OCC Advisory Letter 2004-4, Secured Credit Cards (April 2004)

Each of these guidance documents is discussed below.

1. *Account Management and Loss Allowance Practices Guidance*

In January 2003, the federal bank and thrift regulatory agencies issued guidelines to address concerns with credit card account management practices. The interagency guidance, *Credit Card Lending: Account Management and Loss Allowance Guidance*, the development of which was led by the OCC, addressed five key areas: 1) credit line management, 2) over-limit practices, 3) minimum payment and negative amortization, 4) workout and forbearance practices,

[9] These issuances supplement our examination handbooks and procedures on credit card and retail lending.

and 5) income recognition and loss allowance practices. The issues covered by the guidance initially surfaced in the subprime credit card market, but follow-up examinations identified similar concerns involving several prime credit card lenders.

In particular, through the examination process, examiners had identified concerns with practices for assigning the initial credit lines to borrowers and increasing existing credit lines. In some instances, borrower credit lines were increased without the proper underwriting analysis to support the increases. Some borrowers who then increased their credit card charges were unable to make their payments, which led to an increase in delinquencies and losses. The guidance describes the agencies' expectations for banks when they establish initial credit lines for customers and when they increase those credit lines.

Examiners also identified weaknesses in income recognition and loss allowance practices. Because of the revolving nature of the credit card product and low minimum payment requirements, a portion of the interest and fees were being added to the balances and recognized as income. The agencies' guidance reiterated the principle that generally accepted accounting practices require that loss allowances be established for any uncollectible finance charges and fees. The agencies also directed credit card lenders to ensure that loss allowance methodologies covered the probable losses in high-risk segments of portfolios, such as workout and over-limit accounts. Based on our observations, the industry responded quickly to this portion of the guidance and increased their loss allowances where needed.

Prior to the guidance, examiners also had observed that loan workout and forbearance practices varied widely, and in some instances raised safety and soundness concerns. These workout programs were often not adequate to enable consumers to repay the amounts owed. In

particular, some workout programs extended repayment periods with only modest reduction in the interest rates being charged. To address the concerns raised by these practices, the guidance reminded the industry that workout programs should be structured to maximize principal reduction, and it also stated that repayment periods for workout programs should not exceed sixty months. To achieve this, banks now typically lower interest rates and stop assessing fees.

Over-limit practices, where a borrower exceeds the credit limit on the account, can raise both safety and soundness and consumer fairness concerns. Examiners had observed that credit card accounts had been allowed to remain in over-limit status for prolonged periods with recurring monthly over-limit fees. The guidance directed banks to establish reasonable controls and ensure timely repayment of amounts that exceed credit limits, to promote responsible credit management.

Finally, examiners had become concerned about an industry trend toward declining minimum payment requirements, particularly at a time when credit lines, finance charges, and fees were increasing. Some borrowers who made only the required minimum payments were unable to meaningfully reduce their credit card balances. Others who made such required minimum payments would actually see their principal balance increase. This occurred through the process of "negative amortization," *i.e.*, where the minimum payment was insufficient to cover the finance charges and other fees imposed, including over-limit fees, and the amount unpaid was added to the total outstanding debt. In other words, credit card lenders were allowing borrowers to make minimum payments that were so low that the borrowers' total amount of debt could increase each month even without new charges.

The guidance required banks to address these issues through a systematic reevaluation of payment requirements and fee assessment practices. In particular, the guidance provided that minimum payment requirements pay down balances over a reasonable period of time – amortize them – consistent with the unsecured nature of the underlying debt. The guidance also provided that prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt raise consumer fairness and safety and soundness concerns and are subject to examiner criticism.

The OCC followed up through our supervisory process to ensure that national banks conformed their practices to the guidance. In order to be clear that this occurred, the agency took the unilateral step of drawing a bright line: we directed banks to eliminate prolonged periods of negative amortization by raising their minimum payments to cover all accrued interest and late fees, plus at least one percent of the principal balance outstanding. In addition, we required banks to include other recurring fees (e.g., overlimit fees) in the minimum payment or waive them after three consecutive months. In general, these instructions mean that a consumer that makes his or her required minimum monthly payment will decrease his or her outstanding balance, not increase it.

Most national banks immediately addressed the changes in the guidance relating to credit-line management, workout programs, and loss allowance practices. Conforming changes to over-limit, minimum payments, and negative amortization practices were not immediately implemented, however, and met with stronger resistance from some credit card lenders. This resistance by national bank credit card issuers was based on, among other things, competitive concerns about an "unlevel playing field" with respect to non-national bank credit card issuers who might not be similarly required to implement the guidance. In these instances, the OCC

nevertheless insisted on consistent implementation by national banks of the changes called for in the guidance.

2. *Credit Card Marketing and Change in Terms Practices Guidance*

Credit card practices involving marketing and changes in terms also have been the focus of OCC supervisory guidance because of our concern that they could expose national banks to substantial compliance and reputation risks. The OCC issued Advisory Letter 2004-10 in September 2004 to advise national banks about the risks that these practices may violate the prohibition in the Federal Trade Commission (FTC) Act against unfair or deceptive practices. The Advisory Letter provides that national banks should not:

- Increase a consumer's rate or other fees when the circumstances triggering the increase, or the creditor's right to implement that increase, have not been disclosed fully or prominently;
- Utilize advertising designed to catch a consumer's attention in advertising materials with promotional rates, commonly called "teaser rates," without also clearly disclosing material restrictions on the applicability of those rates; and
- Advertise credit limits "up to" a maximum dollar amount, when that credit limit is, in fact, seldom extended.

a. Universal Default, Unilateral Change in Terms, and Other Pricing Practices

Over the past several years, card issuers have used tools other than the initial interest rate to compensate for increased risks in a customer's profile over time. For instance, some credit card issuers impose a much higher "penalty rate" on a credit card for consumers who do not make timely payments on other obligations to the same lender or on obligations to other lenders – a practice sometimes referred to as "universal default" pricing. Such issuers argue that the

increased interest rate is necessary to address the increased risk indicated by the borrower's default on other credit. But the practice has drawn sharp criticism from consumers – especially when they were unaware that their failure to make payments on other debts could affect the interest rate on their credit card. In the wake of this criticism, very few national banks continue to use universal default pricing. However, default pricing is still commonly used to address defaults on credit obligations with the issuing bank.

Card issuers may also raise the interest rate on a credit card to address other indicators of increased risk. Examples include high use of a consumer's credit line, failure to make timely payments, or a change in credit score (which may or may not reflect consumer behavior with respect to other credit obligations). This type of risk-based pricing is different from universal default pricing because it is typically based on a more sophisticated analysis of risk (rather than a failure to make payments due on other obligations to the card-issuing bank or to other lenders); results in a more calibrated rate increase when warranted; and requires advance notice before taking effect. In addition, most large national bank issuers provide consumers with the right to "opt out" of the increased rate on his or her pre-existing balance, but the ability to use the card for future charges is also generally curtailed. Such risk-based pricing, unlike universal default, is an increasingly common practice for credit card issuers, including national banks.

Lenders have sought to justify risk-based pricing as more reflective of increased risk than simple universal default pricing. They have used similar arguments to justify raising the cost of credit in other ways, such as shortening the period allowed for payments and increasing cash advance, over-the-limit, late payment, or similar fees. In such instances, lenders point particularly to the fact that the risks associated with open-end unsecured credit can increase substantially over time, and that failure to use risk-based pricing could well result in higher up-

front interest charges, more limited credit availability, and shorter terms for card renewals (with increased use of lender options not to renew). While such arguments may well be valid, the increased fees and higher interest rates that accompany risk-based pricing have also been the object of significant public criticism. Risk-based pricing related issues are the source of many consumer complaints the OCC has received – with the sharpest arising from those who were unaware of the circumstances that could trigger such increased costs of credit.

It is important to note that federal law, including TILA, does not restrict the ability of creditors to include provisions in credit card contracts permitting "default" or penalty interest rates, other changes in interest rates, or other changes in the terms of the account. Indeed, Regulation Z implicitly recognizes that penalty rates may be charged in that it requires such rates to be disclosed in solicitations – although the manner of disclosure currently required may not effectively alert customers to these terms. For example, except in certain transactions, the disclosure of when penalty rates will apply is not required in the existing "Schumer box" disclosures, and need not be as detailed as the explanation later provided in the account opening disclosures. Moreover, current Regulation Z rules contain notable anomalies: in contrast to sometimes detailed disclosures provided to consumers about a credit card's costs, Regulation Z currently does not require a disclosure about the material fact that a creditor has reserved the right to change, unilaterally, these costs and any other credit terms.

The OCC addressed compliance and reputation risks that accompany change in terms practices in AL 2004-10. We made clear that, to avoid consumer misunderstanding and complaints of unfairness, we expect national banks to do more than merely comply with the technical requirements in Regulation Z. The OCC guidance states that national banks should disclose, fully and prominently in promotional materials, the specific circumstances under which

the card agreement permits the bank to increase the consumer's APR, fees, or other costs (such as for late payment to another creditor). Additionally, if national banks reserve the right to change the APR, fees, or other credit terms for any reason at the bank's discretion, the OCC advisory provides that this fact should be disclosed fully and prominently in both marketing materials and account agreements.

The OCC advisory does not restrict the ability of a bank to base initial credit pricing decisions, and subsequent changes to pricing, on events of "default" or other risk factors. Indeed, changes in terms can be appropriate ways to manage credit risk in credit card accounts and, as noted above, TILA does not prohibit these actions. But, because of the heightened risks of unfair and deceptive practices involving re-pricing – in particular, when it may not be apparent to a consumer that the increased rate can apply retroactively to existing balances and not solely to new balances – we have advised national banks that they should always fully and prominently disclose this material information before a consumer commits to a credit card contract.

The OCC's experience here is a good example of the significant potential effects of improved consumer disclosures. We believe that, in part because of the disclosures required by our guidance -- and frankly, in part because of the scrutiny of this Subcommittee in its deliberations on the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) -- national banks moved away from the practice of simple universal default pricing. Not only did the disclosures provide consumers with more choice, but they also "shined the spotlight" on the practice, making it more transparent for the public, critics, and members of Congress – and that combination of consumer choice and transparency seemed to have a palpable effect on issuer

behavior. Indeed, the GAO noted in its 2006 report that around the time that the OCC issued AL 2004-10, many issuers stopped using universal default provisions.[10]

b. *Teaser Rate Marketing and Balance Transfer Solicitations*

A common marketing technique used in credit card solicitations involves teaser rates. Frequently, teaser rates are used in promotions seeking to induce new and existing customers to transfer balances from other credit cards. The promotional rate, almost always highlighted prominently in the marketing materials, is usually in effect for a limited period after the account is opened or the relevant balance is transferred. Other important limitations on the availability of the promotional rate, or on the consumer's ability to take advantage of that rate, often apply – although they may not be disclosed prominently. For instance, the lower, promotional rate may apply only to balances that are transferred, and a higher rate may apply to purchases and other credit transactions during the promotional period. Frequently, a consumer's payments during the promotional period are applied first to the transferred balance, and only after this low-rate balance is paid off will payments be applied to balances that are accruing interest at a higher rate. There also may be other costs, such as balance transfer fees, that affect whether the consumer will benefit from accepting a promotional rate offer.

In some circumstances, consumers can lower their credit costs when they transfer balances to a new account with an introductory rate. The costs and limitations on these rates and accounts, by themselves, are not unlawful or inappropriate – but it is vital that the consumer understands the terms of the transaction. Problems arise when consumers accept offers without understanding the true terms. This, in turn, can lead to increased complaints and increased

[10] GAO Report, p. 26.

exposure to claims of "bait and switch," especially when the consumer accepts the offer without knowing the circumstances in which the creditor can change the terms, including unilaterally.

The Federal Reserve Board's Regulation Z governs many aspects of promotional rate offers. Direct mail credit card solicitations must display prominently in a tabular format each APR that will apply to purchases and balance transfers. However, Regulation Z currently does not restrict the ability of a creditor to highlight only the teaser rate in other materials included in the mailing without noting any limitations on the offer (or to do so only in fine print).[11] Further, Regulation Z currently requires no disclosure of the order in which payments will be applied to various balances. Finally, while balance transfer fees must be disclosed in solicitations, they are not required under existing rules to be disclosed in a "prominent location," even in solicitations expressly offering the consumer a promotional rate on a balance transfer.

The OCC's AL 2004-10 provides guidance on how to "fill in the gaps" in these rules for the responsible use of promotional rate advertising. The guidance advises national banks to disclose fully and prominently the categories of balances or charges to which the promotional rate will not apply. The advisory also states that a national bank should not fail to disclose fully and prominently other material limitations, such as the period the rate will be in effect and any circumstances that could shorten the promotional rate period, and related costs. Moreover, if applicable, a national bank should disclose fully and prominently that payments will be applied first to promotional rate balances.

[11] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 amended TILA in several respects to address disclosures affecting credit card accounts, including disclosures related to "introductory rates," minimum payment disclosures, and payment due dates where the creditor may impose a late payment fee.

c. *Marketing Based on Maximum Credit Limits – "Up-to" Offers*

Another marketing practice that the OCC has monitored concerns promotions based on the highest attainable credit limit – such as "you have been pre-approved for credit up to $5,000." We became concerned when we observed that this marketing might be targeting consumers with impaired or limited credit history, and potentially enticing them to accept a credit card based on an illusory "firm offer" of a specific amount of credit. Instead of receiving the credit line that was promoted, these consumers would instead receive a "default credit line" (the minimum credit line) that was significantly lower than the maximum. All too often in marketing of this type, the possibility that a significantly lower credit line might be extended was either not disclosed or disclosed only in fine print or in an obscure location. When initial fees were charged that were high in relation to the credit line extended, consumers who accepted the offer would end up with little initial available credit and little card utility.

The OCC addressed "up to" marketing in AL 2004-10. The advisory states three general guidelines for managing risks and avoiding unfair or deceptive practices in these promotions. First, we advised national banks not to target consumers who have limited or poor credit histories with solicitations for credit cards advertising a maximum credit limit that is far greater than most applicants are likely to receive. Second, we advised national banks to fully and prominently disclose the amount of the default credit line and the possibility that the consumer will receive it, if it is likely that consumers will receive substantially lower default credit lines. Finally, we advised national banks not to promote cards on the basis of card utility if the initial available credit most consumers receive is unlikely to allow those uses.

As noted above, the OCC follows up through the supervisory process to ensure that national banks are addressing risks identified in agency guidance and making changes as appropriate to address those risks. Shortly after we issued AL 2004-10, the OCC reviewed direct marketing materials and credit agreements from eleven national banks with credit card operations, including the largest issuers, to compare how their disclosures on promotional rates and changes in terms conformed to the standards in our advisory letter. In general, we found that most of the banks surveyed disclosed restrictions on teaser rates and the possibility of changes in credit terms, but that the prominence and completeness of these disclosures needed to be improved. The materials we reviewed also generally did a good job of telling the consumer what constitutes a "default" that will give rise to higher default pricing. The materials typically did not warn the consumer, however, about the other types of circumstances – short of "default" – that could result in a change of terms. We provided feedback to the banks we surveyed, and all of the banks concerned addressed the issues we identified.

While AL 2004-10 includes general guidance as well as a number of specific recommendations and requirements, I want to emphasize what it does not do. It does not prohibit universal default, risk-based pricing, or unilateral change-in-terms contract provisions, nor does it define any practice as *per se* unfair or deceptive. While the advisory cautions banks that such practices may involve unfair or deceptive acts or practices or other violations of law, particularly if consumers fail to receive appropriate disclosures of these material contract terms, it does not restrict the ability of a bank to base initial credit pricing decisions, and subsequent changes to pricing, on risk factors. Indeed, as I noted earlier, these practices are not barred by federal law or Regulation Z, and if fairly disclosed and implemented, risk-based pricing and other changes in terms can be appropriate ways to manage credit risk in credit card accounts.

3. *Secured Credit Cards*

The OCC also has issued supervisory guidance that focuses on discrete issues affecting credit card products, such as our guidance on secured credit cards. These cards require a borrower to pledge collateral as security for the credit line extended. The borrowers who receive these cards typically are individuals with limited or blemished credit histories who cannot qualify for an unsecured card. In some respects, these products can benefit these consumers by allowing them to establish or improve their credit histories.

Traditionally, secured credit cards have required that borrowers pledge funds in a deposit account as security for the amounts borrowed under the credit card account. In the event of default, the deposited funds may be used to help satisfy the debt. Over time, however, some issuers began to offer secured credit cards that did not require the consumer to pledge separate funds in a deposit account as collateral in order to open the credit card account. Instead, the security deposit for the account would be charged to the credit card itself upon issuance. This practice resulted in a substantial decrease in the amount of credit that was available for use by the consumer when the account was opened. Unsecured credit card products also have been offered with similar disadvantages, except that account opening fees, rather than a security deposit, are charged to the account and consume much of the nominal credit line assigned by the issuer.

These developments in secured credit card programs – in combination with marketing programs targeted at subprime borrowers that often did not adequately explain the structure or its likely consequences – meant that consumers were misled about the amount of initial available credit, the utility of the card for routine transactions, and the cost of the card. Again, existing

Regulation Z disclosures generally do not provide information to consumers about credit limits and initial available credit. Moreover, while account opening disclosures prescribed by Regulation Z require, if applicable, a general disclosure pertaining to security interests, there is no such requirement for credit card solicitations or advertisements. Thus, these rules omit disclosure of key information that would provide consumers, at a decision point, a full understanding of a secured credit card product's cost and terms. They also offer little guidance to lenders that may have wished to present such information in a comprehensible and responsible manner.

The OCC reviewed marketing materials and found significant omissions of material information about the likely effect that charging security deposits and fees to the account would have on the low credit line that was typically extended, and about the consequent impairment of available credit and card utility. While these marketing practices generally complied with the specific credit cost disclosure requirements of TILA and Regulation Z, the OCC determined that they raised considerable compliance risks under the FTC Act as deceptive practices. We also reviewed whether the practice of charging substantial security deposits and fees to a credit card account and severely reducing the initial credit availability could also be found to be unfair within the meaning of the FTC Act. Evidence available to us indicated that consumers were materially harmed by these practices when the product received by most consumers fails to provide the card utility and credit availability for which consumers have applied and incurred substantial costs. Based on this review, the OCC concluded that this practice also posed considerable compliance risks under the FTC Act.

To address these concerns, the OCC issued Advisory Letter 2004-4, "Secured Credit Cards." The advisory directs national banks not to offer secured credit card products in which

security deposits (and fees) are charged to the credit card account, if that practice will substantially reduce the available credit and the utility of the card. The OCC also advised that national banks should not offer unsecured credit cards that present similar concerns as a result of initial fees charged to the card.

As a result of our advisory letter, supervisory suasion, and enforcement actions described below, we believe that the significant supervisory concerns we had relating to secured credit card products offered by national banks have been addressed.

D. OCC Enforcement Actions

As noted earlier, when our examiners identify an issue, they expect it to be fixed in a timely manner, without having to resort to a formal enforcement action. National banks typically agree to address deficiencies identified in the examination process, and formal enforcement actions are not the first tool we look to in order to achieve corrective action and remediation. Occasionally, however, a bank may dispute the action sought, and a formal action may be needed, or a formal action may be appropriate based on a failure to take the action sought or on the nature and gravity of the issue. In such cases, the OCC will take a formal enforcement action. The OCC has authority to address unsafe and unsound practices and to compel compliance with any law, rule, or regulation, including TILA, the Fair Credit Reporting Act, the Equal Credit Opportunity Act, and the prohibition on unfair or deceptive practices in section 5 of the FTC Act – the principal federal statutes that provide specific protections for credit card applicants and borrowers. This authority allows the OCC to require national banks to cease and desist from engaging in unsafe or unsound practices or actions that violate consumer protection laws. Further, the OCC may seek restitution for affected consumers in these and other

appropriate cases, and assess civil money penalties against banks and their "institution-affiliated parties."

In particular, the OCC was the first federal banking regulator to use its general enforcement authority in combination with the prohibition in section 5 of the FTC Act against unfair and deceptive practices to bring an enforcement action against a national bank in connection with the bank's credit card lending operations. This use of section 5 of the FTC Act was initially greeted with skepticism, but the OCC believed it was both necessary and lawful to address practices that the agency concluded were unfair and deceptive. This enforcement position has since been adopted by all the federal bank regulatory agencies.

Our very first use of this authority in May 2000 led to a consent order that required the bank to, among other things, provide at least $300 million in restitution for deceptive marketing of subprime credit cards and ancillary products; cease engaging in misleading and deceptive marketing practices; and take appropriate measures to prevent such practices in the future, including by modifying its policies and telemarketing scripts to ensure the accurate disclosure of all fees, charges, and product limitations before a consumer purchases a product.

Since that time, we have taken seven additional unfair and deceptive enforcement actions specifically relating to credit card practices, most involving subprime credit card issuers, which are described in Appendix A. In total, these enforcement actions have provided hundreds of millions of dollars in restitution to consumers harmed by unfair or deceptive credit card practices, and have required changes to reform a variety of credit card practices. As a result of our actions, few, if any national banks today specialize in subprime credit card lending.

III. CREDIT CARD DISCLOSURES: EXISTING PRACTICES AND NEED FOR CHANGE

A. Benefits of Effective Disclosure and Shortcomings of Existing Practices

The GAO has observed that disclosures are the primary source of consumer protection for credit card customers under federal law.[12] The OCC agrees with that observation, although, as indicated above, there have been particular circumstances in which the agency has directed card issuers to take particular actions in addition to disclosures to avoid unfair and deceptive practices or for safety and soundness reasons. We believe that truly effective disclosure of credit card fees, costs, and material terms has three fundamental benefits.

First, it provides consumers with meaningful choice, as it allows them to fairly compare the terms of available credit products.

Second, it causes card issuers to engage in healthy competition on the terms disclosed in order to affect those consumer choices, with more firms seeking to provide the terms that consumers really want. Indeed, one can make a strong argument that the simplified disclosures provided in the "Schumer box" as the result of legislation in 1989 helped stimulate the competition that resulted in today's prevailing practice of lower interest rates and the virtual elimination of annual fees.

Third, it makes card issuer practices more transparent, and the glare of publicity can itself affect issuer behavior in ways that benefit consumers. Public scrutiny and criticism of the most aggressive credit card practices, including congressional hearings like this one today, have plainly been a factor in causing a number of card issuers to move away from such practices. Meaningful, effective disclosure facilitates this process – and can cause issuers to think long and

hard before engaging in a new type of aggressive practice that will be exposed immediately to public view.

These, then, are the potential benefits of effective public disclosure. But as this hearing demonstrates, the past few years have witnessed increasing public concern about whether credit card disclosures are in fact truly effective. These increased concerns coincide with – and possibly reflect – significant changes in the way credit card accounts are marketed and managed by card issuers. Indeed, the GAO recently concluded that the disclosures about credit cards currently required by federal regulations have not been effective in protecting consumers against inaccurate and unfair credit card practices.[13] Among other things, the GAO found that disclosures were:

- Written at a level that is not likely to be understood by many consumers;
- Poorly organized and formatted; and
- Overly complex and detailed.

The GAO determined that federal regulations also have not been effective in helping consumers understand certain material terms and conditions of their credit card accounts, including default interest rates, other penalty rate increases, late payment fees, cash advance fees, grace periods, and balance computation methods.

In addition to issues of disclosure quality, a number of credit card practices in existence today have been criticized as inappropriate, misleading, or even unfair to consumers, and some

[12] GAO Report, p 33.
[13] GAO Report, p. 33.

have called for the federal banking agencies – or Congress – to flatly prohibit the practices. For example, practices such as universal default, unilateral change in terms, and the two-cycle average daily balance computation method ("double-cycle billing") have been singled out for particular criticism.

As described above, universal default provisions are triggered and permit a creditor to impose higher rates of interest on new and/or existing credit card balances where the consumer is delinquent on another obligation to the same institution or to another lender. Unilateral change-in-terms provisions, which are common in open-end credit card agreements, permit a lender to change any terms on a credit card account, including the interest rate, for any reason and at any time, most frequently based on indicators of change in the consumer's risk profile, subject to advance notice to the consumer. Double-cycle billing permits a creditor to compute the finance charge based on two billing cycles if a consumer, with no prior balance, makes only a partial payment of the balance by the payment due date. In effect, with double-cycle billing, the "grace period" for making payments without incurring a finance charge is retroactively eliminated. (To illustrate, if a consumer who made $1,000 in purchases in month one pays only $990 of the balance by the payment due date, $10 is carried over into the month two billing cycle. If the credit card issuer uses the double-cycle billing method and no new transactions are made in month two, finance charges on this account would be calculated taking the average daily balance of $1,000 in month one and $10 in month two, instead of calculating it on just the average daily balance of $10 in month two.)[14]

Absent effective disclosure, particular practices may not only be unexpected, but also perceived by the consumer as unfair, such as imposing a penalty rate on existing balances when

the consumer assumed that the rates in effect when the transactions were made would apply until the balances were paid in full, or eliminating the grace period if the consumer's payment is less than the entire outstanding balance when the consumer assumed that it would apply to the extent of any payment made.

As already described, the OCC has taken a number of steps to address the issues raised by inadequate and ineffective disclosure of credit card practices, as well as practices that raise safety and soundness issues or may be characterized as unfair or deceptive under the FTC Act. The tools we use include comprehensive examinations, complaint resolution, and enforcement actions. In addition, we have taken a number of supplementary steps – including issuing preventive guidance – to address issues particular to credit card activities that are not specifically addressed by federal laws or regulations, specifically including inadequate and ineffective disclosure. And, we have seen real improvements in credit card operations as a result of our supervisory activities and corrective steps taken – at our behest – by national banks.

But there are limitations to what can be accomplished through unilateral OCC supervision, supervisory guidance, and case-by-case enforcement actions to change disclosure practices across a highly competitive industry where we do not have rule-writing authority and where some major participants are not subject to OCC supervision. Moreover, the OCC is limited in what we can do where the practices at issue have not been specifically restricted by Congress or existing regulations, and indeed, in some cases are implicitly authorized by Regulation Z in that the regulation expressly prescribes how such practices must be disclosed.

[14] GAO Report, at pp. 27-28.

B. Federal Reserve's Proposed Changes to Regulation Z

That is why the Federal Reserve Board's undertaking to review and revise its Regulation Z disclosure rules is such an important step. Changes to Regulation Z would set new, uniform standards for all credit card issuers, not just national banks. This provides the opportunity to give all credit card customers the key information they want, at the times that they need it, in a form they can readily understand and use.

The Board's current rulemaking is its first major proposed revision to the Regulation Z rules on credit card disclosures since its implementation in 1989 of the Fair Credit and Charge Card Disclosure Act. The features of credit card products that were determined to be most important to consumers then are not necessarily the most important today, given the substantial changes in marketing and product structure and pricing. Thus, the Board's pending rulemaking provides an important and timely opportunity to address industry developments over the past eighteen years, and to develop disclosure rules applicable to all credit card issuers that are effective in helping consumers understand material terms and conditions of credit card products, without undue compliance burden.

Given our supervisory responsibilities, the OCC has a strong interest in the Board's review and revision of the Regulation Z disclosure rules, and we are encouraged that the Board's recent proposal appears to reflect the type of new approach to consumer disclosures that the OCC has been advocating.

In 2005, the OCC submitted a detailed comment letter in response to the Board's Advance Notice of Proposed Rulemaking. Among other things, the OCC urged the Board to

employ both qualitative and quantitative consumer testing,[15] such as the consumer testing process used by the Food and Drug Administration to develop the "Nutrition Facts" label, to ensure that credit card disclosures:

- Focus on key information that is central to the consumer's decision making (with supplementary information provided separately in a fair and clear manner);
- Ensure that this key information is highlighted in such a way that consumers will notice it and understand its significance;
- Employ a standardized disclosure format that consumers can readily navigate; and
- Use simple language and an otherwise user-friendly manner of disclosure.

We also encouraged the Board to reconsider Regulation Z's historical reliance on prescriptive disclosure requirements, and to evaluate whether this approach is best suited to consumer and industry needs in today's rapidly evolving consumer credit markets.

In addition to these general themes, the OCC's comment letter described a number of specific anomalies currently in Regulation Z, and we highlighted certain issues that we believe should be included in any revisions to the rules. For example, we urged the Board to consider whether amendments to Regulation Z could address some of the confusion and concern regarding universal default and unilateral change-in-terms re-pricing. Regulation Z currently addresses the various ways in which an account may be re-priced in very different – and perhaps anomalous – ways. For example, the current Schumer box disclosure requirements do not treat all re-pricing mechanisms the same:

[15] Eight federal agencies, including the federal banking agencies, recently published a proposed model privacy notice that was developed following in-depth consumer testing. *See* 72 FR 14940 (March 29, 2007).

- *Variable Rates.* The issuer must specifically disclose the fact that the rate may vary and provide an explanation of how the rate will be determined, and must comply with detailed rules about the actual numerical rate that is disclosed.

- *Promotional Rates.* The issuer must specifically disclose the promotional rate and provide a large print disclosure of the rate that will apply after expiration of the promotional rate is required. There is no requirement, however, to disclose the different circumstances under which the promotional rate will be or may be terminated.

- *Penalty Rates and Universal Default.* While the issuer must provide specific disclosure of the increased penalty rate that may apply upon the occurrence of one or more specific events, the disclosure of those events is not required to be particularly detailed, or necessarily prominent. Moreover, no disclosure of the duration of the penalty rate is required.

- *Unilateral Change in Terms.* The issuer is under no obligation to disclose its reservation of a unilateral right to increase the interest rate, fees, or any other terms of the account.

Based upon our preliminary review of the Board's proposal, we believe the new approach to disclosures reflected in the Board's proposal is very constructive and consistent with a number of the suggestions that we made. We particularly endorse the Board's extensive use of consumer testing to guide the design of effective disclosure material and the Board's commitment to further testing after it receives comments from the public on the proposal. The proposal also takes steps to address various change-in-terms issues that are the source of many consumer complaints. We also commend the proposal's approach to use standardized formats for disclosures in various contexts, such as account opening, periodic statements, and change-in-terms notices. As we study the proposal further, we expect to have further comments and suggestions on it. For example, we believe that the Board should explore the possibility, consistent with its legal authority, of providing consumers with the right to opt-out of unilateral changes in terms that increase pricing on existing credit balances. As noted above, the ability to opt-out of changes in terms is already provided by most large national banks to their credit card customers. Of course, we are still in the process of reviewing all of the details of the proposal in light of our recommendations, our existing guidance, and our supervisory experience with credit

card issuers, and we look forward to working with the Board on these issues as their rulemaking progresses.

IV. CONCLUSION

In a relatively short time, credit cards have become a credit and payment access device that is used by a majority of Americans. Credit cards provide substantial benefits to consumers, including convenience, security, and worldwide acceptance. And, they generate substantial benefits to the economy.

Credit card terms, marketing, and account management practices have been changing in recent years in response to intense market competition for customers and revenue. While these market innovations have resulted in benefits to consumers, the beneficial impact has not always been uniform. Developments in account management and pricing practices have made the terms of credit cards more complex and difficult for consumers to understand. The OCC has addressed some of these risks through our supervision of national bank credit card operations, our enforcement actions, and our supervisory guidance, but there are limits to what the OCC can do, alone, across a highly competitive industry where some major participants are not subject to OCC supervision.

Although there have been calls for legislative and regulatory restrictions on certain credit card practices, the focus of today's hearing is on the role of consumer disclosures in regulating the credit card market. It is clear that current disclosures are not working well. That is why the Board's undertaking to review and revise its disclosure rules under Regulations Z is so important. Changes to Regulation Z would set new standards that apply to all participants in the credit card industry. And improved disclosure industry-wide can have multiple benefits for

consumers: informed consumer choice; issuer competition to provide consumers the terms they want; and transparency that would "shine the spotlight" on credit card practices making it more difficult for issuers to withstand public criticism of those practices that are especially aggressive.

Will such improved disclosure be sufficient to address the fundamental issues raised by current credit card practices? We certainly hope so, and we believe the proposed changes to Regulation Z, along with other sound changes that likely will be suggested during the comment period, show real promise of addressing many important issues that have been raised in the current debate. Moreover, we would note that – partly due to public criticism raised by members of Congress and others – most national bank issuers have already moved away from such practices as universal default and double-cycle billing. We also believe, however, that since credit card practices are regulated primarily through consumer disclosures, more frequent reviews of, and updates to, the applicable Regulation Z disclosure rules than has been the case in the past would be beneficial.

In addition, there are potential costs associated with going beyond disclosure, which has been the cornerstone of federal consumer protection regulation for credit card users. As I noted at the outset, open-end credit such as credit cards, where each transaction is a new extension of unsecured credit that is not separately underwritten, requires ongoing and prudent risk management. Banks need to have the tools to contain their credit risk on credit card accounts due to risk factors such as fluctuations in the rate environment, adjustments in business strategy, market developments, and changes in a borrower's creditworthiness. This can be done in part by closing accounts, shortening account expiration dates, and/or limiting further credit advances. But, risk-based pricing is also an effective tool used by card issuers to target and manage such risks – so long as it is effectively disclosed. Proposals to restrict this tool could have unintended

consequences regarding banks' ability to manage risks, or in the alternative, on the availability and affordability of credit cards more generally.

As Congress continues to weigh these issues, the OCC stands ready to provide additional information that the Subcommittee may need based on the OCC's supervision of national banks.

* * *

Appendix A

- (Consent order – September 25, 2000). Bank required to discontinue its misleading and deceptive advertising of credit cards and to take appropriate measures to prevent the recurrence of such advertising.
- (Consent order – May 3, 2001). Bank required to provide restitution of approximately $3.2 million for deceptive credit card marketing, to discontinue its misleading and deceptive marketing practices, and to make substantial changes in marketing practices.
- (Consent order – December 3, 2001). Bank required to provide restitution of at least $4 million for misleading and deceptive credit card marketing, to discontinue its misleading and deceptive advertising practices, and to make substantial changes in its marketing practices and consumer disclosures.
- (Formal agreement – July 18, 2002). Bank required to discontinue its misleading and deceptive advertising practices, and to take appropriate actions to prevent deceptive advertising concerning credit lines and the amount of initial available credit.
- (Consent order – January 17, 2003). Bank required to provide restitution of at least $6 million for deceptive credit card marketing practices, to obtain prior OCC approval for marketing subprime credit cards to non-customers, to cease engaging in misleading and deceptive advertising, and to take other actions.
- (Formal agreement – March 25, 2003). Bank required to provide restitution for deceptive practices in connection with private label credit cards, resulting in a pay out of more than $6 million to date, and to make appropriate improvements in its compliance program.
- (Formal agreement – July 31, 2003). Bank required to make restitution of approximately $1.9 million for deceptive credit card practices.
- (Consent order – May 24, 2004). Bank required to make at least $10 million in restitution for consumers harmed by unfair practices, and prohibited from offering secured credit cards in which the security deposit is charged to the consumer's credit card account.

Testimony of John G. Finneran, Jr., General Counsel, Capital One Financial Corporation before the United States House Subcommittee on Financial Institutions

June 7, 2007

Chairwoman Maloney, Ranking Member Gillmor and Members of the Committee, good morning. My name is John Finneran and I am the General Counsel of Capital One Financial Corporation. Thank you for this opportunity to address the Subcommittee. Capital One is the 11th largest diversified financial institution in the country and the 5th largest issuer of credit cards.

Today, the credit card is among the most popular forms of payment in America. It is valued by consumers and merchants alike for its convenience, efficiency and security.

As the GAO noted in their recent report on this topic, the past decade has seen substantial change in the availability and pricing of credit cards. Today, many more Americans have access to credit through credit cards than at any previous time. As the GAO found, interest rates have come down significantly for the majority of consumers and most pay no annual fees. Consumers who choose to pay in full each month, as more than half of all credit card holders do, pay no interest.

Credit cards have also become more complex, with a variety of benefits and terms. The disclosure regime under the Truth in Lending Act, as implemented by Regulation Z, did not contemplate this complexity. In recent years, Capital One has implemented a "dynamic disclosure" regime – focused on simple and timely communication of critical information – but has found itself constrained by outdated requirements and the current limits of the Schumer Box.

Today we focus on the Federal Reserve's proposed comprehensive overhaul of Regulation Z. We at Capital One want to join with those who have praised the Board for the depth and thoroughness of its proposal. Capital One commented in advance of the rule with its own recommendations for comprehensive change, and we are pleased to find in this Proposal rules that incorporate many of our recommendations.

For years, Capital One has been focused on two critical priorities which we believe to be essential to the empowerment of our customers and the health of our industry – disclosure and default repricing. Although we have not had time to assess the full implications of this Proposal, we believe that the Board has focused appropriately on these issues, as well.

Consumers, regulators and the industry all agree that disclosures must be improved. The Federal Reserve's effort marks a landmark advance in how disclosures are developed. To craft its model disclosures and notices, the

Federal Reserve went directly to consumers, administered focus groups and tests, and drafted recommendations based on what they learned. Consumer testing has been an integral part of Capital One's business strategy since its inception, and we are strong believers in its merits.

The Federal Reserve's proposal, if adopted, would transform the basic concept of disclosure altogether. It would move to a targeted regime of plain English notices that are delivered to customers at the moment when they are most relevant to them. We strongly support the Board's proposal in this regard.

As importantly, the Federal Reserve's proposal has identified what Capital One believes to be the most challenging practice in the industry today – aggressive default repricing. Requiring card issuers to notify consumers forty five days prior to default repricing is a bold proposal. Capital One has addressed this issue in a different way – with a single, simple default repricing policy that provides our customers with a warning before we will consider taking any action. Our policy is that Capital One will not default reprice any customer unless they pay 3 or more days late twice in a 12 month period. After their first infraction, customers are provided with a prominent statement on their monthly bill alerting them that they may be repriced if they pay late again. Furthermore, the decision to reprice someone is not automatic. For many customers, Capital One chooses not to do so. If we do reprice someone, we will let them earn back their prior rate by paying us on time for twelve consecutive months. This process is automatic.

To be clear, Capital One does not practice any form of "universal default." This has been our long-standing policy. We will not reprice a customer if they pay late on another account with us or any other lender, or because their credit score goes down for any reason. In addition, Capital One will not reprice customers if they go over their limit or bounce a check.

While the Federal Reserve offers a different approach, we share the same goal: ensuring that customers receive a warning before they are repriced, and an opportunity to learn about the potential consequences of their behavior. We hope the Federal Reserve will consider the merits of our current approach, and determine whether some additional flexibility in the final rule is warranted.

Although the optimal means of eliminating aggressive default repricing may be the subject of some debate during this hearing, Capital One recommends that the Federal Reserve go one step further: issuers should be required to tell customers the specific type of infraction that caused the change in their interest rates. Today, when a customer is repriced for breaking a contractual rule, such as paying late, going over their limit or defaulting on another account, the issuer is under no obligation to explain why. We believe that disclosing the infraction that caused the repricing will create a "teachable moment" and will enable customers to gain the full benefits of greater transparency.

With these achievements alone -- a new disclosure regime and an extended warning period for repricing - the Fed has broken significant new ground. As issuers, however, we have an obligation to ensure that customers not only understand the products we offer, but that our practices meet the standards of reasonableness and fairness our customers expect. To this end, Capital One continuously reviews and makes changes to its practices in light of changing customer preferences.

Consistent with the Board's proposal, Capital One has adopted strict policies regarding the marketing and treatment of fixed rates. Our fixed rates are not subject to any form of repricing during the specific period for which they are promised. This policy has been in effect for several years, and we are pleased that the Board has sought to achieve consistency across the industry on the use of this term.

Similarly, another practice that may cause customer confusion is double-cycle billing. Capital One has never used double-cycle billing.

The overwhelming majority of Capital One's customers use their accounts responsibly and enjoy the many benefits this form of payment offers. Capital One looks for early indications, however, that a particular customer may be experiencing challenges. For example, any customer who pays us only the minimum for three consecutive months receives a notice on their statement that

emphasizes the consequences of this practice and encourages them to pay down their balance more quickly. Capital One also provides them with a web address where they can use our online calculator to see for themselves the cost of paying only the minimum, as well as the benefits of paying additional principal. While we support the Federal Reserve's efforts to provide more information in this regard, we believe that our current approach – providing notice only to those who actually routinely pay the minimum – enhances the relevancy of the disclosure and better advances the Federal Reserve's stated objective of developing a more targeted and dynamic disclosure regime.

In conclusion, we believe that the Federal Reserve's proposal represents a positive step forward for consumers and our industry. At Capital One, however, we do not view it as a substitute for continuously adapting our practices and policies to keep up with consumer demand, the rigors of competition and the standards of sound banking. Capital One has over 30 million credit card customers, the vast majority of whom have a good experience with our product. When they don't, we regard that as a failure and seek to find out why. In a highly competitive market, we must continuously strive to improve our products and services if we are to attract and retain the best customers.

Thank you and I look forward to answering any questions you may have.

WRITTEN STATEMENT OF JAMES A. HUIZINGA
SIDLEY AUSTIN LLP

BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

IMPROVING CREDIT CARD CONSUMER PROTECTION: RECENT INDUSTRY AND REGULATORY INITIATIVES

JUNE 7, 2007

Good morning Chairwoman Maloney, Ranking Member Gillmor, and members of the Subcommittee. My name is Jim Huizinga and I am a partner in the Washington, DC office of Sidley Austin LLP. I have advised clients on credit card programs for over 25 years. It is my pleasure to appear before you today to discuss the evolution of the credit card industry and the recent proposed revisions to Regulation Z by the Board of Governors of the Federal Reserve System ("Board").

Congress enacted the Truth in Lending Act, or TILA, almost 40 years ago to provide consumer protections in the developing consumer credit marketplace. The Board has regulatory authority to implement TILA through its Regulation Z. TILA requires comprehensive cost disclosures for consumers so consumers can shop for credit on an informed basis, and thereby facilitates competition among creditors. Standardized disclosures under TILA foster competition among credit card issuers on the basis of the account terms that Congress and the Board have determined are the most important to consumers, such as interest rates and fees. Competition facilitated by these disclosures is especially effective in the credit card industry because there is wide availability of credit card offerings, and balance transfer features allow consumers to move easily from one card issuer to another at little or no cost.

The last overhaul of the credit card rules in Regulation Z was in the early 1980's, when credit cards were generally a "one size fits all" product. Many of us remember when it seemed like most cards had a $20 annual fee and 19.8% APR. However, advances in credit underwriting and technology over the last 25 years have allowed card issuers to adopt more sophisticated and individualized pricing models. For example, risk-based pricing allows credit card issuers to tailor the costs of credit to the individual risks presented by different consumers. Risk-based pricing benefits consumers by lowering the cost of credit to many consumers while making it possible to offer credit to those who are less creditworthy. In addition, like in many other industries, credit card issuers have increasingly "de-bundled" pricing so that fees are imposed on users of particular services or cardholders that cause issuers to incur particular expenses. From an economic standpoint, the current pricing models can provide significant advantages to consumers.

The recent study of the credit card industry by the General Accounting Office ("GAO") shows that newer pricing methods are providing benefits to many consumers. The GAO found that a majority of consumers had lower interest rates in 2005 than they had in 1990, and that

since 1996 credit card interest rates generally have fallen with market rates like the prime interest rate. In addition, the GAO found that, over the same general time period, there was no significant increase in the total of annual fees and penalty fees paid by cardholders, and the profits of major credit card issuers remained relatively level. In 2005, approximately 80% of credit card accounts were assessed interest at rates lower than 20% and about 40% were assessed interest at rates lower than 15%.

Although the credit card industry has evolved significantly over the years, TILA's basic methods of protecting consumers -- helping consumers shop for credit on an informed basis and increasing competition among credit card issuers -- can be just as effective today as when Regulation Z was first adopted. Indeed, the development of balance transfers in relatively recent years has intensified competition among credit card issuers and increased the effectiveness of disclosures. However, it is appropriate to update Regulation Z disclosures to enhance consumers' ability to shop for credit cards in today's marketplace on the basis of the most useful information. The Board recognized this need to update Regulation Z several years ago, and published an advance notice of rule making at the end of 2004. Further, just two weeks ago, the Board released an exhaustive 800-page proposal that comprehensively considers current pricing methods and practices in the credit card industry, and would rewrite major portions of the credit card rules in Regulation Z.

The Board's proposal seeks to increase the understandability and usefulness of Regulation Z disclosures. Although it is likely that industry and consumer groups will both seek many changes to the Board's proposal, I believe there is strong support for the notion that credit card disclosures can be improved. I also believe the proposal is, generally, a major step in the right direction. I think it is critically important that, for the most part, the proposal avoids price controls and similar restrictions. Price controls seldom work and it is far preferable to allow the fierce competition in the marketplace to drive the future development of credit card products. Credit cards have come to play an increasingly important part of most consumers' lives, providing many benefits not available through other financial service products. We take shopping on the Internet or by telephone, renting a car or reserving a hotel room, and obtaining interest free loans for granted. But price controls can threaten the widespread availability of credit cards, especially for those less creditworthy, and artificially distort pricing mechanisms. Price controls are especially unwarranted in light of the proposed improved disclosures under Regulation Z that will allow consumers to take better advantage of vigorous competition in the marketplace to find the credit card product most suited for them.

Significantly, the Board's proposal is based on actual consumer testing on which types of disclosures actually work. The Board has attempted to determine what consumers want to see in disclosures, not necessarily what consumer groups, industry, or the Board itself might assume consumers want. The Board used the consumer testing to develop disclosures that are aimed at those account terms most important to consumers in shopping for credit. The Board explicitly stated that consumers could easily suffer from information overload if the disclosures were too dense with jargon or terms that consumers do not understand, or simply too long. The Board also designed the revised disclosures to present important information in a way that increases consumer understanding, and also recognizes that many consumers do not want to spend a lot of time studying disclosures that are written in excessive detail.

The Board's proposal contains very significant changes in disclosures based on these considerations. Broadly speaking, among other things, the Board proposes:

(1) to improve and increase disclosures relating to newer pricing methods, including "penalty" pricing;

(2) to expand use of standardized charts to facilitate easy and quick review of credit terms, including new disclosure charts when an account is opened and when account terms are changed;

(3) to use new terminology that consumers understand, such as "interest" and "fees," instead of legal terms such as "finance charge" that have little meaning to consumers; and

(4) to group information on monthly billing statements so the disclosures are more meaningful and understandable to consumers.

The Board's proposal also would adopt a significant substantive protection to facilitate the ability of a consumer to move credit card balances to another creditor because of an interest rate increase. In particular, Regulation Z would extend the advance notice period for interest rate increases from 15 to 45 days and, for the first time, apply that longer notice period before penalty interest rates could be imposed. These changes are designed to better allow a consumer to shop for a new credit card, such as by responding to a solicitation in the mail or by walking into a local bank branch, and to transfer a credit card balance to a new creditor if the consumer qualifies for a better rate.

Having said this, I also believe the Board may need to consider some changes to its proposal. It is far too early to assess the operational impact some of the revisions may have. Some of the items included in the proposal, however, appear at first blush to impose significant costs on the industry without providing counterbalancing benefits to consumers. The net result may be increased credit costs for consumers without appreciable consumer benefits. For example, the expectation that certain disclosures would be provided on legal size paper is a costly proposition, especially when standard sized paper would probably provide comparable results for consumers. Furthermore, the Board's proposed complete redesign of periodic statements will require substantial resources for card issuers which may or may not be justified in light of the fact that periodic statements tend not to be particularly confusing for consumers today. The prohibition on adjusting consumers' APR based on risky behavior for 45 days—*even if the adjustment is part of the contract*—may also go too far.

In conclusion, I believe that the underlying approach of TILA and Regulation Z to consumer protection for credit cards is just as, if not more, effective as when originally adopted. Given the significant competition in the credit card marketplace, a well informed consumer can have literally dozens of options when choosing a credit card. Over the past several years it has become clear that Regulation Z needs an overhaul if consumers are to be well informed with respect to credit card products. The Board has done an admirable job in proposing necessary changes to Regulation Z to ensure consumers do, in fact, receive the information they need with

regard to today's credit card products. As Congress has determined time and time again when enacting, amending, and reviewing TILA, full disclosure is the best approach to consumer protection and credit cards. Given the Board's proposed revisions, I do not believe it is appropriate to change course.

Thank you again Chairwoman Maloney for the opportunity to appear before your Subcommittee today. I would be happy to answer any questions you may have.



STATEMENT

OF

THE HONORABLE JOANN M. JOHNSON
CHAIRMAN
NATIONAL CREDIT UNION ADMINISTRATION

"REGULATION Z AND CREDIT CARD DISCLOSURE REVISIONS"

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT
U.S. HOUSE OF REPRESENTATIVES

THURSDAY, JUNE 7, 2007

I. Introduction

The National Credit Union Administration's (NCUA) primary mission is to ensure safety and soundness, as well as compliance with applicable federal regulations for federally insured credit unions. It performs this important public function by examining all federal credit unions, participating in the supervision of federally insured state-chartered credit unions in coordination with state regulators, and insuring credit union member accounts. In its statutory role as the administrator for the National Credit Union Share Insurance Fund, NCUA provides oversight and supervision to approximately 8,305 federally insured credit unions, representing 98 percent of all credit unions and approximately 86 million members. [1]

NCUA has enforcement authority for Regulation Z in all federally chartered credit unions. In addition to the provisions of the Truth In Lending Act (TILA) and Regulation Z, federal credit unions are subject to further requirements in the Federal Credit Union Act and NCUA's Rules and Regulations. NCUA evaluates federal credit union compliance with these requirements through its examination and supervision process.

[1] Approximately 174 state chartered credit unions are privately insured and are not subject to NCUA oversight.

Credit Unions and Regulation Z

The TILA encourages the informed use of credit by consumers. It promotes meaningful disclosure of credit terms to enable consumers to compare credit terms and also protects consumers against inaccurate and unfair credit billing and credit card practices. [2]

The Federal Reserve Board's (FRB) Regulation Z implements TILA. [3] Regulation Z applies to both federally-chartered and state-chartered credit unions. While NCUA is responsible for examining and enforcing federal credit union compliance with Regulation Z, the Federal Trade Commission has responsibility for its enforcement for state-chartered credit unions.[4]

NCUA is authorized to and has established its own examination procedures to enforce compliance with Regulation Z, using a risk-based examination and supervision approach.[5] NCUA can require a federal credit union to adjust a borrower's account to correct errors resulting from an inaccurately disclosed annual percentage rate or finance charge. NCUA also can exercise the cease and desist authority it has under the Federal Credit Union Act to correct an unsafe or unsound business practice or a violation of applicable

[2] 15 U.S.C. § 1601.
[3] 12 C.F.R. § 226.
[4] Consumer Credit Protection Act, § 108(c) of title I.
[5] See infra page __.

laws and regulations.[6] If a credit union fails to comply with the requirements of a cease and desist order, civil money penalties may be assessed.

In addition to its examination and enforcement authority, NCUA alerts federal credit unions of FRB changes to Regulation Z, informs federal credit unions of operational matters for their consideration related to the regulation, responds to inquiries from federal credit unions, responds to complaints from credit union members, and consults with the legal staff of the FRB regarding Regulation Z matters. NCUA uses Regulatory Alerts, Letters to Credit Unions, and Legal Opinion Letters to assist federal credit unions, and where appropriate, federally-insured state-chartered credit unions, in remaining informed of their responsibilities under the regulation and in promoting safe and sound business operations.

Regulatory alerts are used to communicate information about regulatory changes by other federal agencies to federal credit unions. NCUA has issued several regulatory alerts to federal credit unions concerning FRB revisions and amendments to Regulation Z.[7] Letters to Credit Unions are used to relay guidance and instruction arising from NCUA's internal experience and observation to federal credit unions and, where appropriate, federally-insured

[6] 12 U.S.C. § 1786(b),(e).
[7] Revised Regulation Z Commentary (97-RA-7), Revisions to Regulation Z (98-RA-1), Interagency guidance on Electronic Financial services and Consumer Compliance (98-RA-4), Regulation Z Truth in Lending (01-RA-01), Interim Final Rules Amending Regulations B, E, M, Z and DD – Electronic Delivery of Required Disclosures (01-RA-08), Amendment in Lending to Regulation Z Truth in Lending (01-RA-15), Regulation Z Implementation of Home Ownership and Equity Protection Act, and Regulation Z – Revisions to the Official Staff Commentary (03-RA-08).

state-chartered credit unions. Since 1977, NCUA has provided credit unions with letters discussing various Truth-in-Lending matters, for example, disclosures concerning payroll deduction plans,[8] interest rate adjustment errors for Adjustable Rate Mortgage loans,[9] and compliance and other risks in home equity lending.[10] NCUA has not issued any Letters to Credit Unions concerning credit card activities recently as the agency's examination data and complaint data have not indicated any systemic or pervasive problems in this area.[11] Legal Opinion Letters are used to clarify and discuss the application of existing regulatory requirements to specific scenarios, and, when responding to questions concerning Regulation Z, NCUA consults with legal staff at the FRB. NCUA has addressed a number of Regulation Z topics in this manner, such as, whether a particular fee is a finance charge[12] and risk-based pricing disclosures.[13]

[8] Truth-In-Lending Disclosures – Payroll Deduction Plan 2 (Letter to Credit Unions No. 16, 11/18/77, inactive).
[9] Interest Rate Adjustment Errors for ARM Loan (Letter to Credit Unions No. 120, 01/00/91).
[10] Risks Associated with Home Equity Lending (05-CU-07, May 2005).
[11] See infra at page __.
[12] For example, OGC Opinion Letter Nos. 91-0412 (Re: Late Charges), 00-1217 (Re: Interest Rate Limits and Transaction Fees on Credit Card Cash Advances), and 05-0903 (Re: Skip-A-Payment Disclosures).
[13] For example, OGC Opinion Letter Nos. 98-0141 (Re: Risk-Based Pricing Disclosure Notice) and 04-0325 (Re: Risk-Based Credit Card Accounts).

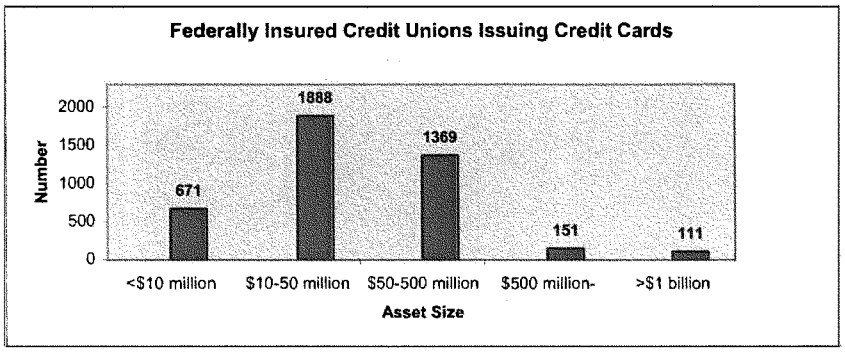
II. Credit Card Programs In Federally Insured Credit Unions

Federally Insured Credit Unions

As of March 31, 2007, 50 percent of all federally insured credit unions (4,190) offer credit cards to their members. Federally insured credit unions represent a small portion of the credit card market with outstanding credit card balances totaling $25.7 billion, or roughly 3 percent of the $775 billion of outstanding credit card balances in the entire marketplace.[14] Federally insured credit unions represent 6 percent of the $410.6 billion in outstanding credit card balances at all federally insured depository institutions.[15] Credit card loan growth in federally insured credit unions has averaged 4.28 percent over the last five years, with outstanding credit card balances representing 5 percent of their total loans outstanding. The average outstanding credit card balance reported by federally insured credit unions at the end of 2006 was $2,117 per account, with an average reported interest rate of 11.38 percent. The most frequently reported interest rate was 9.9 percent.

[14] Based on 12/31/2006 data supplied by Brookwood Capital, as referenced in the May 9th edition of the Credit Union Times magazine, Vol. 18, No. 19. 2007.
[15] NCUA data from 03/31/2007 5300 Call Report and *FDIC- Statistics on Depository Institutions Report, Net Loans and Leases for all depository insured institutions as of 12/31/2006.* 31 Dec. 2006. Federal Deposit Insurance Corporation. <http://www2.fdic.gov/sdi/main.asp>.

More than 60 percent of all federally insured credit unions issuing credit



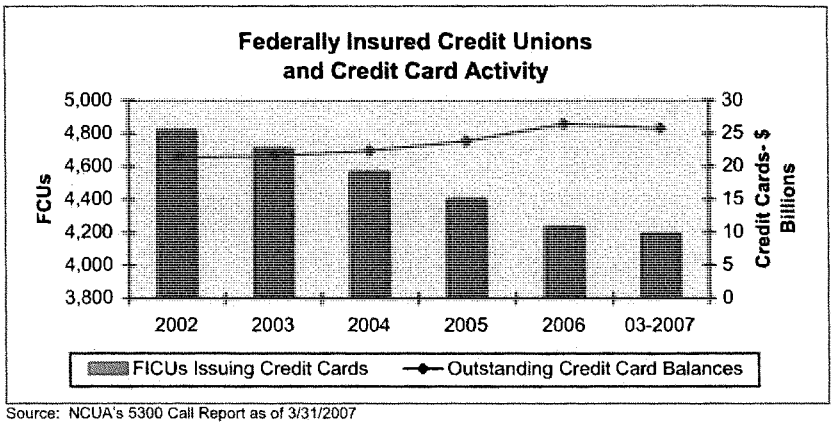
Source: NCUA's 5300 Call Report as of 3/31/2007

cards to their members are institutions with assets of less than $50 million. These credit unions do not enjoy the same economies of scale as large issuers. Federally insured credit unions often partner with other credit unions, credit union service organizations, card processors, or card issuers in order to reduce the significant operating expenses required for the processing and servicing of credit card programs.

As interest rates and credit union cost of funds for federally insured credit unions have risen, the net interest margin earned on all loan types has declined. Since all federal credit unions are prohibited from increasing their loan rates beyond a current regulatory 18 percent cap and market interest rates have increased, the interest margin available to cover the losses from higher risk borrowers has declined for many federally insured credit unions.[16] Rising

[16] 12 U.S.C. §§1757(5)(A)(vii)

variable costs and fixed interest margin potential may have persuaded many federally insured credit unions to sell or discontinue



Source: NCUA's 5300 Call Report as of 3/31/2007

their credit card programs in recent years. Credit card portfolio brokers estimate 318 credit unions have sold their credit card portfolios totalling approximately $2.2 billion in outstanding credit card balances over the last five years.[17] Through portfolio sales and consolidation, the number of federally insured credit unions issuing credit cards has declined by more than 13 percent since 2002.

Federal Preemption of State Law

By comparison with other federal financial regulators, NCUA has narrowly exercised its authority under the U.S. Constitution and the Federal Credit Union Act to preempt state laws.[18] In brief, NCUA, by regulation, only preempts state

[17] Credit card portfolio sales data for credit unions with more than $1 million in credit card balances outstanding. Brookwood Capital. Press release dated May 21, 2007. <http://www.brookwoodcapital.net>

[18] For example, NCUA has not asserted preemption of state law on behalf of or for the benefit of credit union service organizations (CUSOs). CUSOs are legal entities, generally organized as corporations under state law, in which federal credit unions can invest or to which they can lend if the CUSO is engaged in certain approved activities related to the routine operations of credit unions. 12 U.S.C. §§1757(5)(D), 1757(7); 12 C.F.R. §712.5. NCUA does not have direct jurisdiction; it is noted the recent case of *Watters*

laws affecting the rates, terms, and conditions of loans that federal credit unions can offer and state laws affecting fees for opening, maintaining or closing savings, checking, and certificate accounts.[19]

Federal preemption, for NCUA and other federal regulators, stems from the Supremacy Clause of the U.S. Constitution[20] that provides the laws of the United States shall be the supreme law of the land, notwithstanding any state laws to the contrary. Federal preemption can be express, as when it is set out in a statute, or implied, from an overall reading of a statute as to the congressional intent. NCUA's long-standing position is that the Federal Credit Union Act establishes express preemption of state law in the area of lending as far as rates, terms, and conditions.[21]

The practical benefit of federal preemption for federally chartered financial institutions, including credit unions, is that they generally can look to the law and

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v. Wachovia, [ADD CITE], addressing preemption of state law for federal operating subsidiaries of banks, has no effect on NCUA's preemption position.

[19] 12 C.F.R. §§701.21(b), 701.35(c).

[20] , U.S. Constitution, Art. V, cl. 2

[21] The Federal Credit Union Act states:

> A Federal credit union . . . shall have power—
>
> . . . .
>
> (5) to make loans, the maturities of which shall not exceed twelve years except as otherwise provided herein, and extend lines of credit to its members, to other credit unions, and to credit union organizations and to participate with other credit unions, credit union organizations, or financial organization in making loans to credit union members in accordance with the following:
>
> (A) Loans to members shall be made in conformity with criteria established by the board of directors . . . .

12 U.S.C. §1757(5). The Federal Credit Union Act also expressly gives the board of directors of a federal credit union the authority to determine the rates of interest on loans, the security, maximum amount of loans and lines of credit, and, generally, the authority and responsibility to establish lending policies subject to NCUA regulation. 12 U.S.C. §1761b(8)(20).

regulations of their federal regulator to ensure compliance rather than dealing with a patchwork of state and local laws applicable to state-chartered financial institutions. Given that federal credit unions, like other federally chartered financial institutions, may have branches in several states, the benefits include uniform compliance for all locations, thus reducing the regulatory burden of tracking compliance with the laws of various state and local jurisdictions.

NCUA's lending regulation specifically states NCUA does not preempt certain areas of state law, for example, insurance laws, laws relating to security interests in property, laws on collection costs and attorney fees. Particularly relevant to discussion of consumer disclosures and current issues being raised about credit card lending, NCUA's regulation specifically states NCUA does not preempt state laws that require consumer lending documents be in "plain language."[22]

While NCUA will generally not preempt state disclosure laws -- meaning, laws requiring the disclosure of certain information to consumers -- NCUA has preempted state law that, although cast as a disclosure law, is, in effect, a law controlling the rates, terms, and conditions of lending. For example, in 2002, NCUA's Office of General Counsel issued a legal opinion concluding that a California law dealing with credit card provisions was preempted.[23] Briefly summarized, the state law at issue required, among other things, particular

[22] 12 C.F.R. §701.21(b)(2)(iii).
[23] OGC Legal Opinion 02-0638 (June 26, 2002)(available on agency website).

disclosures, counseling services, and toll-free numbers established to provide assistance, if the card holders were permitted to make a monthly payment of less than 10 percent of the balance due. In other words, the disclosure requirements were triggered depending on the repayment terms of the line of credit and, therefore, NCUA concluded the state law limited and affected the "terms of repayment, including . . . the amount, uniformity, and frequency of payments," which is specifically preempted under NCUA's regulation.[24]

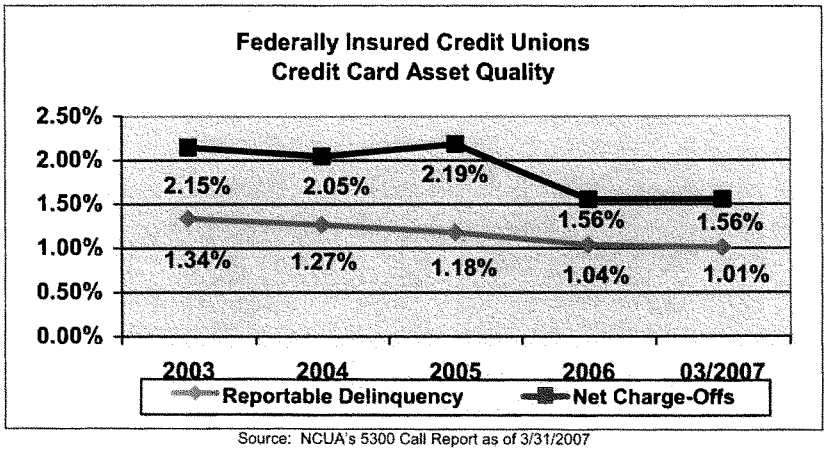
Finally, it should be noted, because it is particularly pertinent to consumer issues in credit card transactions, that NCUA's preemption regulation provides that, where federal law other than the Federal Credit Union Act primarily regulates aspects of credit transactions, NCUA will determine whether state law applies or is preempted under the preemption standards relevant to that federal law. For example, as Regulation Z is primarily a disclosure regulation, NCUA will consider the preemption standards of the FRB under Regulation Z in determining whether state law applies. In fact, when questions arise in this area, NCUA staff will routinely consult with FRB staff.

Credit Card Performance in Federally Insured Credit Unions

Currently, credit card asset quality ratios indicate that credit card portfolios in federally insured credit unions are performing soundly. Reportable credit card delinquency, which NCUA defines as accounts sixty days or more past due, has

[24] 12 C.F.R. §701.21.

been on the decline in federally insured credit unions for the last five years. Likewise, net charge-offs of credit card accounts have declined significantly. These asset quality ratios indicate federally insured credit unions are soundly underwriting credit card loans. At the end of 2006, federally insured credit union "past due" credit card rates (30 days or more past due) of 2.32 percent compared favorably to the "past due" credit card rate for other federally insured depositories of 3.98 percent.



Source: NCUA's 5300 Call Report as of 3/31/2007

One of the factors contributing to the enhanced asset quality of credit card loans in federally chartered credit unions may be the current 18 percent regulatory cap on interest rates for federal credit unions. Due to the interest rate cap, federal credit unions cannot charge high interest penalty or default rates, such as the 27 percent penalty rates being charged by some non-credit unions noted in the Government Accountability Office's September 2006 report on credit

cards.[25] This regulatory limitation on interest rates prevents federal credit unions from charging default or penalty interest rates, thereby protecting the consumer from higher rates. However, the interest rate ceiling also limits the ability of credit unions to mitigate the higher credit risk of some borrowers through risk-based pricing and may ultimately limit access to credit for some members.

As of March 2007, the average of the most common credit card interest rate being reported by all federally insured credit unions was 11.38 percent, with the most frequently reported interest rate being 9.9 percent. These average rates are lower than the national average of interest rates for standard and "gold" credit cards and variable rate "platinum" cards.[26] One recent study observed fewer complexities and more consumer friendly terms and conditions in the credit cards offered by the ten largest credit union credit card issuers versus other large credit card issuers.[27] Lower than average rates and fees are an indication that credit unions serve their purpose in providing a member-oriented approach to credit card underwriting.

Statutory Limit on Interest Rates

Federal credit unions are subject to a regulatory framework containing significant consumer protections for lending transactions. In addition to

[25] Government Accountability Office, "Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers," September 2006. GAO-06-929.

[26] Bankrate.com©, "Credit Cards-National Averages," Bankrate, Inc.©, May17, 2007. <http://www.bankrate.com/brm/publ/cc_top_ten_mkt.asp>

[27] Tim Westrich and Malcolm Bush. "Blindfolded Into Debt: A Comparison of Costs and Conditions at Banks and Credit Unions," Woodstock Institute, July 2005. <http://www.woodstockinst.org/publications/research_reports>

Regulation Z, federal credit unions must comply with lending requirements established in the Federal Credit Union Act and NCUA's lending regulations.[28]

The Federal Credit Union Act limits the interest rate on all lending by federal credit unions to 15 percent unless the NCUA Board acts to set a different rate.[29] By statute, if the Board sets a higher permissible interest rate, the rate remains in effect for only an 18-month period; the rate reverts to 15 percent unless the Board again reviews it and determines whether to set a different rate. Currently, the interest rate cap is 18 percent, a rate the NCUA Board has maintained since May 1987. The interest rate cap is applied to the unpaid loan balance and includes all finance charges, in effect, providing a ceiling on the effective interest rate charged at any time on a loan.

NCUA's long standing policy is to include any credit fees as finance charges in determining the interest rate cap if those fees would be deemed finance charges under the FRB's Regulation Z.[30] NCUA, in addition to relying on Regulation Z, has consulted with legal staff of the FRB for guidance on what constitutes a finance charge. Because finance charges are a component of the interest rate cap, fees can be charged only if the resulting effective interest rate does not exceed the cap. As a result, fees commonly applied by other card issuers, for example balance transfer and cash advance fees, generally cannot

[28] 12 U.S.C. § 1757(5)(A)(vi), 12 C.F.R. §§ 701.21, 701.22, 706, 722, and 723.
[29] 12 U.S.C. § 1757(5)(A)(vi).
[30] 12 C.F.R. § 226.4(b).

be imposed by federal credit unions because including these fees will mean the interest rate will exceed the permissible cap.

In addition to the interest rate cap, NCUA's regulations also impose restrictions on so-called "pyramiding." The agency prohibits federal credit unions from "pyramiding" late fees.[31] Pyramiding refers to a situation where a late fee is imposed on a timely payment simply because an outstanding late fee, from an earlier payment period, exists. Under NCUA's regulation, as long as the payment due for the current period is paid in full and on time, a federal credit union may not impose a late fee for the current period. Essentially, NCUA's regulation prevents charging a late fee on a late fee.

III. NCUA's Role in Enforcement and Complaint Resolution

NCUA plays a significant role in enforcing Regulation Z in federal credit unions. Through its examination program and complaint monitoring process, NCUA helps to ensure credit unions are compliant and consumers are appropriately protected by applicable federal regulations.

NCUA Oversight and Enforcement

NCUA performs risk-focused examinations and supervision as a part of its statutory enforcement and oversight responsibilities. Compliance is one of the

[31] 12 C.F.R. § 706.4.

seven risk areas upon which NCUA's risk-focused examination program is built.[32] In risk-focused examinations, examiners assign a level of risk (high, medium, low) for each of the seven risk areas and then develop a scope for each examination or supervision contact based upon a credit union's individual risk factors.

Examiners utilize NCUA's Automated Integrated Regulatory Examination Software (AIRES), which uses questionnaires to guide and document reviews.[33] NCUA examiners provide basic compliance oversight for the federal credit unions in their district, reviewing compliance areas that indicate levels of risk. Within the AIRES application, examiners have access to questionnaires for each compliance regulation for which NCUA has enforcement authority. These questionnaires provide the following key components on each regulation:

- Summary of the basic purpose or applicability of the law/regulation;
- NCUA's enforcement responsibility;
- Penalties resulting from failure to comply;
- Record retention requirements, if any; and
- Key questions for consideration during the review and general information to assist the examiner.

[32] NCUA's risk-focused examination program focuses on the following seven risk areas: Interest Rate, Liquidity, Credit, Strategic, Compliance, Transaction, and Reputation Risks. See NCUA Letter to Federal Credit Unions 02-FCU-09, *Risk-Focused Examination Program.*

[33] The AIRES questionnaire workbook is available at <http://www.ncua.gov/CreditUnionResources/aires/aires.html>

When violations are noted, examiners document them in NCUA's centralized Compliance Regulations Violations database. Additionally, examiners develop and communicate recommended corrective actions to credit union personnel and/or credit union officials, develop and recommend corrective solutions to be included in the examination report, and reach agreements on appropriate corrective action.

During the 7,899 examination and supervision contacts completed in federal credit unions during 2006, NCUA noted 305 violations of Regulation Z. Of the violations noted, 147 were addressed through Documents of Resolution, 108 were addressed through Examiner's Findings, and the remaining 50 were addressed through other informal actions.[34] Only 17 of the violations noted were specific to credit cards. Few formal enforcement actions related to Regulation Z have been necessary in federally insured credit unions.

Consumer Complaint Resolution

NCUA central and regional offices have systems to track incoming complaints and responses. Each of the five NCUA regional offices has staff who review and evaluate any consumer complaints. Federal credit unions also have Supervisory Committees comprised of credit union members whose primary

[34] NCUA examiners use the Examiner's Findings workpaper, as part of an examination or supervision report, to list material operating exceptions, violations of law or regulation, and unsafe and unsound policies, practices, and procedures. NCUA examiners use Documents of Resolution, a separate section in an examination or supervision report, to outline plans and agreements reached with the officials to reduce areas of unacceptable risk. Failure to resolve Documents of Resolution will lead to NCUA taking progressive enforcement action.

duties include oversight of internal audit functions and ensuring credit union member assets are safeguarded.

Depending on the nature of a complaint, incoming complaints are investigated and the credit union is requested to provide an explanation of the circumstances. Regional staff encourage the resolution of the matter voluntarily, but are authorized and prepared to invoke the agency's administrative action authority, if necessary, to achieve a proper outcome. Regional Directors are responsible for making determinations about necessary action on a case-by-case basis and coordinating responses with the central office.[35]

Review of regional complaint logs since 2004 show relatively few complaints specifically related to credit card practices or Regulation Z. A total of 306 complaints related to these topics were logged with regional offices during this time period, with 80 specifically pertaining to credit card issues. In most instances, complaints about credit cards focused on misunderstandings of loan terms, authorization and account status issues, and payment disputes. Regional staff normally resolves complaints by providing additional information to the complainant or arranging direct follow-up by NCUA examiner staff.

[35] NCUA Instruction No. 12400.05, dated April 23, 2004

NCUA Promotion of Financial Education

Credit unions have demonstrated that they view financial education as a natural outgrowth of their service-oriented philosophy. Increased financial literacy represents an ounce of prevention that can help all consumers avoid getting in over their heads, and actually enable them to use their money wisely and improve their financial health. The advertising slogan "an educated consumer is our best customer" is very apt when discussing the value of financial literacy.

NCUA is a member of the Financial Literacy and Education Commission (the Commission), a federal entity established under the Financial Literacy and Education Improvement Act, enacted by Title V of the Fair and Accurate Credit Transactions Act of 2003, to improve financial literacy and education of persons in the United States.

The principal duties of the Commission include: (1) encouraging government and private sector efforts to promote financial literacy; (2) coordinating financial education efforts of the federal government, including the identification and promotion of best practices; (3) the development of a national strategy to promote financial literacy and education among all American consumers; (4) the establishment of a website to serve as a clearinghouse and provide a coordinated point of entry for information about federal financial literacy and education programs, grants, and other information; and (5) the establishment

of a toll-free hotline available to members of the public seeking information about issues pertaining to financial literacy and education.

In addition to serving as a member of the Commission, NCUA Chairman Johnson has served as Chairman of its MyMoney.gov website subcommittee since October 2006. The MyMoney.gov web site was created to provide public access to financial education tools and resources, which will empower Americans to save, invest and manage money wisely to meet personal goals. In this role, the Chairman coordinates the efforts of twenty federal agencies to improve financial education across the nation.

The Access Across America initiative, announced in February 2002, incorporated the Agency's activities for federally insured credit unions expanding services into underserved areas. The program has been designed to partner with federal government agencies and other organizations to identify and facilitate the use of resources available for federally insured credit unions to assist in their efforts to serve individuals in underserved areas.

Another program NCUA developed to help consumers and improve financial literacy is the Community Development Revolving Loan Fund (CDRLF). The CDRLF awards grants and loans to low-income designated credit unions to enable them to provide financial services to their communities, including financial education. Financial education programs often include topics such as,

understanding credit, understanding finance charges, managing personal credit, credit awareness and budgeting.

In 2004, NCUA created a Financial Education grant initiative to provide members with practical money management skills. Since 2004, NCUA has awarded $461,885 in technical assistance grants to credit unions for financial education and related purposes.

Proposed Amendments to Regulation Z

The FRB is in the midst of an extensive review of Regulation Z to determine where revisions to the regulation are necessary. The first phase of its review covers open-end credit with its initial efforts directed towards lines of credit that are not secured by a home, for example, general purpose credit cards. As a part of this review, the FRB recently issued proposed amendments to the open-end credit provisions of Regulation Z.[36] NCUA staff attended the open meeting where the major changes in the proposal were discussed. While NCUA staff is currently reviewing the considerable documentation accompanying the rulemaking, NCUA would like to take this opportunity to provide an initial comment on the proposed rule.

NCUA generally supports the FRB's attempt to provide information to consumers in a consistent, easily readable manner. The changes should aid

[36] 72 Fed. Reg. _____ (, 2007)

consumers in identifying rates and understanding important conditions related to their use of the credit product, facilitate comparisons of credit products, and promote responsible use of credit products. The changes also appear to provide lenders with more direction on their responsibilities under the regulation.

The FRB issued two Advanced Notices of Proposed Rulemakings[37] to receive comment on the effectiveness of its existing rules and conducted intensive consumer testing to determine if its proposed changes produced useful disclosures for consumers. The findings suggested changes are necessary concerning the content and display of information in the Schumer box, [38] periodic statements, solicitation letters, account-opening disclosures, and change-in-terms notices. The FRB also proposed changes to areas causing confusion and compliance burdens to lenders, for example, distinctions between finance charges and other charges, timing and content of fee disclosures, and required use of certain terminology. NCUA will be looking closely at all of the proposed changes in the coming weeks to evaluate the potential impact on federal credit unions and their members.

IV. Conclusion

As member owned and controlled financial institutions, federally insured credit unions offer products and services for the benefit of their members.

[37] 69 Fed. Reg. 70925 (December 8, 2004); 70 Fed. Reg. 60235 (October 17, 2005)
[38] Common name for the table of abbreviated disclosures required for credit card applications and solicitations under § 226.5a of Regulation Z.

Although federally insured credit unions represent a small portion of the credit card market, NCUA's view is that the credit card services are being provided to their members in a sound and beneficial manner. The disclosure requirements of Regulation Z correspond closely with the credit union mission of member service and NCUA evaluates federal credit union compliance with those requirements. Through its examination and supervision process, complaint monitoring, and consumer education initiatives, NCUA works to ensure compliance with all applicable federal laws. As the FRB works to improve the required disclosures of information for open-end credit, NCUA will continue to fulfill its enforcement responsibilities for any implemented changes.

Testimony of Kathleen E. Keest
Center for Responsible Lending

Before the U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives"

June 7, 2007

Chair Maloney, Ranking Member Gillmor, and members of the Committee, thank you for your continuing attention to the serious issues facing consumers in the credit card marketplace as it functions now. We appreciate the focus you bring today to the regulatory environment that has fostered an unequal playing field between card issuers and card holders, leading to insufficient competition in what really matters to consumers – fair terms and fair pricing, and insufficient accountability.

The Center for Responsible Lending (CRL) is an affiliate of the non-profit community development lender Self-Help, whose mission is to create and protect ownership opportunities for low-wealth families.[1] We understand that the rules in the marketplace for credit cards in turn affect the goals of asset- and wealth-building. For many Americans, it is the entry point into the world of credit. Their experience with credit cards can either expand the boundaries of their life choices or limit their options for years to come.

These cards may set the pace for their long-term debt loads. The credit card experience impacts their credit scores, which in turn affects not only later financial decisions, but also educational and job opportunities.[2] For others, unfortunately, it becomes the mechanism by which needed medicines and medical care is obtained, even as health care and insurance costs rise, making access to care and treatment more difficult to afford. The extraordinary credit card debt among older consumers, at least in part, is likely to be a reflection of this emerging economic reality.[3]

Finally, for millions of homeowners, it is the hook by which debt consolidation mortgage loans are marketed. We do know that for millions of Americans, credit card debt has played a role in the loss of equity in their homes, and, for some, the loss of their homes to foreclosure.[4] In sum, there is a lot riding for American families and the American economy on having fair rules for the credit card marketplace.

My testimony today focuses exclusively on one chapter of the rulebook for this marketplace – the disclosure rules under the Truth in Lending Act's Regulation Z.[5] As the Subcommittee knows, on May 23, the Federal Reserve Board proposed its first major revision of the credit card disclosure rules in nearly forty years – four decades that have

seen enormous changes in the credit card industry. We ask three questions about this proposal:

1. How will the disclosures be made? Will they be user-friendly and comprehensible?

2. What information will be required in those disclosures? Will they include the information necessary to assure both informed choice by consumers *and* an honest, competitive industry?

3. Will the proposal adequately deal with the abusive practices that the public – and many in Congress – have identified? Is disclosure enough to curb those practices, or is more needed to assure that they do not turn a valuable and almost necessary financial tool – credit cards -- into "pick-pocket products"?

We believe that as to the first question, the Board's proposal gets high marks. As to the second, we give it a "needs improvement" grade. As to the third, the answer to the question posed, unfortunately, is a simple "No, it does not adequately deal with abusive practices."

Before addressing each of these questions, it is important to remind ourselves what Truth in Lending was – and, more importantly, what it was *not* -- designed or intended to do.

I. THE ROLE OF TRUTH IN LENDING

The Overall Purpose of Truth in Lending:

The Board's proposal cites only two purposes for TIL: 1) meaningful disclosure to facilitate comparison shopping and avoid the uninformed use of credit, and 2) to protect consumers against inaccurate and unfair credit billing and credit card practices, 15 U.S.C. §1601(a). These are critical goals of TIL, but it is an incomplete list. The efficacy of the proposals must be weighed against additional purposes of TIL, as well.

In addition to establishing consumers' "right to be informed" about the true cost of using credit, there are at least three other major goals that focus on providers and on the marketplace: [6]

* to enhance honest competition and protect "*ethical and efficient*" credit-extenders, as well as consumers;

* to protect the integrity of the marketplace from "fraudulent, deceitful, or grossly misleading information,

* to facilitate general economic stabilization: an informed consumer credit market helps "stabilize the economy by encouraging consumer restraint when interest rates increase, and consumer activity when rates drop."

These goals are even more important in today's credit card marketplace than they were forty years ago.

Disclosure in a changed legal context: TIL's disclosure approach was designed as a complement to substantive regulation, not a substitute for it.

When Truth in Lending -- and most of the current credit card disclosure rules -- were written,[7] consumer credit was also subject to substantive regulation by the states. The disclosure system mandated by the Truth in Lending Act was designed and intended as a *complement* to substantive regulation, not a substitute for it. State law interest rate ceilings for consumer credit – both revolving and closed-end -- were the norm at the time.[8] Other types of charges and fees were often limited in amount, or prohibited entirely, as well.

Congress explicitly did not disturb the states' substantive regulation of the "types, amounts or rates of charges, or any element of elements of charges" in enacting TIL.[9] It did not envision disclosure as the sole bulwark in a marketplace stripped of substantive regulation. The first step on the slippery slope to credit card "deregulation by exportation" – the *Marquette* decision – was still 10 years away when the disclosure paradigm under Reg. Z, Part B was designed.[10] In 1980, when Congress enacted a major revision of Truth in Lending, open-end disclosure rules were barely touched. While Congress gave state chartered banks parity with national banks (the beneficiaries of the *Marquette* decision.) at that time,[11] the full implications of *Marquette* for the credit card industry had not then registered to law-makers or the public. It was not until the mid-1980s that this ripple-effect *sub rosa* substantive deregulation of the credit card industry began to become apparent.[12] In sum, disclosure today is being asked by some to carry alone a *legal* burden that it shared with substantive regulation when much of the current open-end disclosure rules were devised.

Disclosure in a changed economic context:

Just as the legal context has changed drastically since the current regime was designed, so, too, has the economic context. Consumer debt is a more important part of the economy, making it more important than ever to assure a fair marketplace. Revolving debt was $1.5 billion in May, 1968, when TIL was passed; it was $801 billion in January, 2005.[13] In 1977, households charged a little more than $100 a month on credit cards, or 3.4% of average monthly household income. Twenty years later, the average charges for those who have used cards to pay were $830, or 20% of average household monthly income.[14] The revolving debt share of total non-mortgage consumer credit grew from 1.4% in May, 1968 to nearly 38% in January, 2005.[15] In 2001, nearly $1 in $4 of consumer expenditures was paid by a credit card.[16] Today, household spending is 60% of the American economy. It is unlikely a coincidence that household debt as a percentage of disposable income was at a record 108% in 2003.[17]

Even those astonishing figures understate credit card debt. The phenomenal growth in home equity lending is fed by marketing debt consolidation refinancing, so a significant

amount of credit card debt has disappeared into mortgage statistics. And, as Attorney General offices and advocates who have worked with consumers in the predatory mortgage lending context can attest, a lot of that begins with the pitch to consolidate credit cards into "one easy monthly payment" and a loan that's tax-deductible. In fact, even student loans may now disguise consolidated credit card debt.

And a changed market context:

Credit card market changes have undergone several generations of evolution since the fundamental open-end structure was established nearly forty years ago. It is more complex and more highly concentrated.

When TIL rules were originally designed, surveys indicated that consumers getting closed-end loans underestimated the true cost of borrowing – misconceptions that resulted from varying ways of calculating interest, as well as from loading up credit with so-called "non-interest" charges that "rightfully should be included in the percentage rate statement so that any percentage rate quoted is completely meaningless and deceptive."[18]

In many respects the subsequent evolution of the open-end consumer credit market has brought this segment to the same stage of dysfunction described above by Senator Douglas, the economist and primary champion of Truth In Lending in the 1960s.

* Opaque and complex accounting methods in open-end credit today distort cost information and competition even more than the varying types of interest calculation used in closed-end credit before 1968.[19]

* Non-interest fee income in the industry was nearly one-third (31.8%) of total revenue by 2005.[20] To generate revenue, the industry has shifted from the upfront, transparent interest rate to back-end fees, along with the accounting tricks, practices that hinder effective price competition. This resurrects Senator Douglas' criticism of the "camouflaging" of credit costs by the addition of all sorts of fees.

* Individualized pricing and multiple pricing layers have been introduced (e.g. transaction charges for different types of cash advances may vary, the grace period and rates for different types of charges may vary). These changes make pricing information difficult to convey simply and comprehensibly. Flexible pricing, such as penalty rates, also make transaction pricing far more complex and ever-changing. Such industry inventions create higher hurdles to clear in developing useable disclosure rules.

* Finally, the creditors' extraordinary freedom to unilaterally change contract terms at will subsequent to consummation means even effective disclosure rules for solicitation and initial stages can be pointless.

Thus at the same time that disclosure is being asked to carry a heavier load in the legal context, even some economists have joined consumers in questioning the efficacy of

disclosure as a practical matter.[21] It is critically important to understand that increasing complexity has profound implications for a regulatory scheme resting on disclosures.

If increasing complexity (some of it arguably purposefully obfuscatory) creates a hurdle on the provider side, many recognize that inadequate financial literacy on the user side is no less a hurdle.[22] The mismatch between the complex information that consumers need, and the ease with which the intended audience can comprehend and use that information, seems to be getting greater. Disclosure not only is carrying a heavier burden, but it must bridge a greater divide while it does so.

It is against the backdrop of these increased challenges facing consumers in today's marketplace that I evaluate some of the highlights in the current proposal.[23]

II. HOW WILL THE DISCLOSURES BE MADE UNDER THE PROPOSED RULES?
A PASSING GRADE

Looking to focus groups of consumers to learn how information should be presented to make it used and useful is the single most valuable thing the Board has done in this revision. The improvement in the "account-opening" disclosures (formerly called "initial disclosures") show the most dramatic improvement. Members of this Subcommittee, like every other American who has had a credit card, know that the disclosures and "agreement" that come with opening a credit card account are unreadable. Moreover, they would be virtually incomprehensible to anyone but their authors if they were actually read. We are happy to see that the Board's proposal recognizes that simple, unarguable fact. A review of the sample forms, compared to any current one in your own files, is ample evidence of the improvement.

Utilizing the "Schumer Box" formatting model at all stages is a significant improvement.

The one set of TIL-required disclosures that is currently usable by consumers is the "Schumer Box" – the tabular disclosure of rates and fees now mandated only for the applications and solicitations.[24] Under the proposed rules, there would be a Schumer box of tabular, segregated disclosures for the other stages of the credit card life-cycle: "account-opening," the periodic statement, and change in terms notices.

Creditors would also be required to segregate interest costs and fees from the consumer's purchases and advances on the periodic statement, making those costs more readily visible to the consumer.

Increased Advance Notice for Change in Terms, and Added Advance Notice for the Triggering of Penalty Rates are Significant Improvements, Although Substantive Limitations are Still Needed

Increased advanced notice of change in terms from 15 days to 45 days: Currently, issuers unilaterally may change any term in a credit card contract -- a rare gift in contract law. Truth in Lending currently requires only 15-days advance notice, a hopelessly inadequate time to permit most cardholders to avoid disadvantageous new terms.[25] While we believe that the ability to unilaterally change contract terms is a practice that should be the subject of more substantive restriction, as we discuss below, the Board has nonetheless recognized that the 15-days currently required is so short as to be meaningless, and has proposed to extend it to 45 days. This is a significant improvement, which we urge the Board to retain in the final rule.

Advanced notice would be required when penalty rates are triggered – increased from 0 to 45 days: Currently, if a penalty rate provided for in the contract is triggered, arguably **no** advance notice is required. The Board's recommendation would, for the first time, specify that advance notice is required, subjecting this re-pricing to a 45-day notice.

We are encouraged by the recognition that advance notice is necessary. The consumer may not even know the penalty rate had been triggered until after the fact, when their next periodic statement comes. This is obviously inadequate for a consumer to take action to avoid it. It may have been months – or even years – since the consumer received notice of the existence of the penalty rate and what events trigger it. Even then, that notice may not have been noticeable or informative.

More critically, the consumer may not even be aware that a trigger event has occurred. Payments may be "late" because of the creditor's posting practices, not the consumer's mailing schedule; trigger events that are external, including drops in a FICO score, may occur without the consumer even knowing they happened. To then be faced with a potential 10% rate hike when they receive their statement is a huge challenge. Simply paying it off during the grace period may work for people with ample resources or small balances, but for most revolvers – the average balance is reported to be over $5,000[26] -- that may well not be possible. Searching out other cards for transfers takes time, and there is typically an exit fee, in the form of a balance transfer fee.

We hope that the Board will stand firm on the 45-day notice for both actions, as that is a minimal time necessary for consumers to avoid the harsh results that come from re-pricing or other adverse actions.

III. WHAT MUST BE DISCLOSED?
NEEDS IMPROVEMENT

The proposal includes revisions as to the content of the disclosures. Some proposals would bring genuine improvements to the disclosures. Others represent a step forward, but more could and should be done about the underlying practices. Unfortunately, some also threaten a step backward for consumers.

Highlights of the Improvements Proposed in the Content of the Disclosures

* All transaction fees will be included in the finance charge: Transaction fees, including ATM cash advance and foreign currency conversion fees will be included in the finance charge. (However, the beneficial impact of this change may be offset by other proposed changes, discussed below.)

* Subprime credit cards: For low-limit, high-fee cards, the proposal would add a new requirement that the amount of available credit must be disclosed on the application/solicitation and account-opening disclosures.

Subprime cards function more as "pick pocket products" than as credit cards. With very low credit limits, and very high fees to open and participate in the account, the consumer can find more than half of the credit line filled up with fees before the cardholder ever uses the card. Furthermore, manipulative accounting tricks make the imposition of over-the-limit charges more likely, or even almost impossible to avoid.

These cards claim to offer a way to repair credit, more than a payment mechanism. (Google "First Premier Bank credit card" and the sponsored link site for the bank that pops up first says, "Rebuild your **credit** with a **First Premier Bank Credit Card.**" How does that work? Pay a lot of money in fees for the privilege of – paying fees, and little else.)

One customer's experience with such a card was detailed in CRL's Comments filed in response to the Board's Advance Notice of Proposed Rule-Making. It had a "low" 9.9%" rate for purchases. It also had a $250 credit limit; a $29 set up fee, a $95 program fee, a $48 annual fee, and a $6 monthly participation fee.[27] That added up to $178 in creditor charges posted on the account immediately upon opening, leaving just $72 for actual purchases. But account manipulation then set up a series of cascading over-the-limit fees that made it impossible for her to get ahead, even when she paid timely and as directed.

For the first time, the Board proposes rules aimed squarely at these products. While more could, and should, be done, the Board is recommending the addition of an important new disclosure especially for these products. Where the fees imposed for issuing or making the account available compose 25% or more of the minimum credit limit, the card issuer must disclose the amount of the available credit left open after the fees are charged against the limit. This disclosure must be made at both application / solicitation stages and the account opening stages.[28]

The proposal would also amend the Official Staff Commentary to provide that a consumer is not considered to have "accepted" the card when the only activity on the account is the creditor's imposition of the charges, until the consumer has been sent a billing statement and made a payment.[29]

* Improvements in advertising requirements: The proposals include two changes to the advertising requirements that may prove helpful to consumers.

- Prohibiting advertising "fixed" rates, unless they are fixed, at least for a certain time, which must be specified.

- The minimum payment would be a trigger term on advertisements for credit purchases of specific goods or services. If a minimum payment is mentioned, the advertisement must also state the total of payments and the time period necessary to repay the obligation.

This is in response to a problem that a number of state attorneys general brought to the attention of the Board nearly ten years ago, regarding "spurious open-end credit," in which door-to-door sellers of expensive items, including home repairs, air conditioning, satellite dishes, etc., would finance through special "credit cards" issued by partnering banks. These accounts were unlikely to be used again, but the virtually worthless open-end disclosures were given, so that consumers had no idea of the full cost of the purchase they were about to make.[30] Here, too, although more could be, and should be done, to curb this problem, this is a welcome step forward.

Improvements to the advertising rules, however, must be viewed in light of the weak enforcement available for TIL advertising. There is no private right of action for violations of the TIL advertising provisions, so only public enforcement is a possibility. Given the regulatory efforts to restrict the right of state attorneys general to enforce even non-preempted state laws – such as state laws against deceptive practices in sales and advertising – it is unclear whether even the attorneys general who brought the problem to the Board's attention today would be able to act against card issuers who teamed up with such sellers.[31]

Areas of Serious Concern that Reduce Consumer Protections

* Limiting fees required to be disclosed on applications/solicitations, at account opening, and in change in terms to an exclusive list.

Experience has shown that where there are loopholes in TIL's disclosure and computational rules, they will be exploited. Charges that need not be included in the "price tag" finance charge and APR disclosures become more common and inflated. It is predictable, then, that mandating the disclosure of an *exclusive* list of fees and charges will lead to another generation of imaginative new fees. Given the fee inflation that has occurred in the decades since *Marquette*, it can hardly be said that the marketplace is in need of further incentives in that regard.

According to the Board, this proposal aims to ease creditor uncertainty about how to disclose new fees, and reduce litigation risks. However, there is another way to accomplish the same end – one that does not run the risk of increasing "off-the-chart" fees and doing harm to the letter and spirit of the Act. The definition of "finance charge"

in the statute is very broad, and the exceptions from that broad definition in the statute are very few. The definition is

> "the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit." 15 USC § 1605(a).

If the Board were to require that creditors simply use the statute itself as the touchstone, there should be very little doubt as to how new fees should be treated. But unfortunately, that is a path not taken.

The charges to be disclosed are ones that indeed may cover most of the typical charges in today's market. The concern, however, is that many of the charges in today's marketplace were unheard of in yesterday's marketplace, and so tomorrow's marketplace may look more fee-intensive yet. (Who would have thought we might one day have to pay to make our payments?)

* The Board proposes two alternatives for the disclosure of the "fully-loaded" APR price tag – the "effective APR" – on the periodic statement. One is to improve it, but the other is to **eliminate it entirely.**

The industry's shift to complex fee-based pricing makes comparison shopping difficult.[32] However, an "all-inclusive" APR on the periodic statement that reflects both rate-based costs and fees costs helps consumers focus on the real price tag and should foster a competitive marketplace.

The Board advances the alternative of eliminating the disclosure because consumers did not understand the term. But that should have been no surprise. Indeed, in our comments to the Board's 2005 ANPRM, we noted the confusion generated by inconsistent terminology around the rate-only APR (the "corresponding" or "nominal APR or "corresponding nominal APR") and the fee + rate APR, which also can be labeled with different adjectives, such as "effective APR" or "historic APR" or "actual APR." The existing rules permit this semantic anarchy, contributing to consumer confusion. The simple solution, of course, is to improve the price tag, not tear it off. Mandating consistent terminology, with a simple descriptive phrase such as has been the standard in closed-end credit for decades, would advance understanding significantly.[33]

The Board's experience with the focus groups appears to have borne out this approach. As it improved the sample disclosure of this term given the participants in the focus groups, their comprehension grew. The final form, with the descriptive term ***"fee-inclusive APR"*** and a short explanatory phrase noting that it represented fees as well as interest resulted in a majority of the participants understanding the information.

We strongly urge keeping the fee-inclusive APR. It is the closest a credit card customer gets to a "fully-loaded" price tag.[34] Eliminating it not only would *hamper* consumer

appreciation of the full cost of credit, its elimination would also contribute to a shift to more fees, a fact that even an industry trade group admitted: "[a] trade association commenter concedes a policy argument for retaining the effective APR as a hedge against creditors shifting their pricing from periodic rates to transaction-triggered fees and charges." (Proposed Rule, Reg. Z, Docket No R-1286, page 114 (May 23, 2007).

* *If retained, the "fee-inclusive" or effective APR may allow some fees to be excluded from its calculation – again encouraging a shift to the "outside-the-rate" fees.*

The proposed rules for calculating the "fee-inclusive" APR again refer to an exclusive list of fees, leaving others outside the calculation.

To illustrate: "participation fees" that are imposed annually are not included, while participation fees imposed more frequently than annually would be included.

Thus Advance America's $149.95 monthly participation fee on its $500-credit limit line of credit – quite properly – would have to be added to the finance charges resulting from the reasonable 5.98% interest-rate to disclose an eye-popping 600+% APR on a $300 draw.

On the other hand, neither the $150 annual fee nor the $29 "activation" fee imposed upon opening the $300 credit-limit account reportedly charged for a credit card issued by Compu Credit would be captured by the "fee-inclusive" APR on the first periodic statement. [35] It also has a $6.50 monthly maintenance fee. But since that fee is not applied to a balance, this would, apparently, be a "0%" effective APR.[36]

We do appreciate the Board's recognition that such fees like Advance America's outrageous $150 monthly "participation fee" on a $500 limit account, or Capital One's relatively reasonable fee of $6 / $1,000, may be imposed "as a substitute for interest or in addition to interest" and therefore should be captured.[37]

But here, too, the use of an exclusive list of captured fees has the likely result that some creditors will be encouraged to develop new "off the list" fees. The Board mentions here, as well, its concern with providing certainty to creditors – a goal that could just as well be achieved by an "all-in" rule, but which would serve to encourage transparent pricing and discourage fee-proliferation.

* Account-specific minimum payment disclosures are encouraged, but not mandated by the proposal; Congress should reconsider the bankruptcy act amendments

The Board strongly encourages creditors to make the disclosure of the amount of time it would take to repay a balance at the minimum payment based on the consumers' own account, rather than a hypothetical account. It offers some modest incentives to do so, but does not mandate account-specific minimum payment disclosures.[38]

The alternatives to account-specific disclosures are cumbersome, and their usefulness may range from not very helpful to possibly misleading. However, in this respect, the Board clearly felt constrained by the minimum payment disclosure scheme enacted by Congress. Those alternatives are laid out in the statute, as amended by the 2005 Bankruptcy amendments.[39] We urge Congress to revisit the issue, and mandate what the Board clearly understands is both feasible for the industry and preferable for consumers – account-specific disclosures of the time it would take to pay off their account at the minimum payment.

IV: BEYOND DISCLOSURE: CONGRESS MUST ACT TO CURB THE ABUSES IN THE CREDIT CARD MARKETPLACE

In many previous hearings in both the House and the Senate, a number of clear abuses in the marketplace have been repeatedly documented. Several proposals have been introduced in both the House and Senate to stop these abuses.

While the Congressional proposals would ban, or otherwise substantively regulate them, the Board does not propose to do so. We believe the Board does have authority to declare them to be "unfair" or "deceptive practices" under 12 U.S.C. § 57a(f). In fact, in 2002, then Congressman John LaFalce asked the Board to use that authority to address some credit card abuses.[40] (While any such rules would apply to banks, the overwhelming majority of credit cards are issued by banks, so most of the market would be subject to a Fed-promulgated rule. [41])

Many, if not most, of these practices would qualify for such a characterization. The test for an "unfair" practice under the FTC Act is a three-pronged test: a) it causes a substantial injury to consumers; b) the injury is not outweighed by countervailing benefits to consumers or competition, and c) consumers cannot reasonably avoid the injury.[42]

These practices have been described by several witnesses in an earlier hearing before this Subcommitee, and will be discussed today by another witness, Ed Mierswinski. I will not repeat their explanations of the practices that give us most concern: universal default; re-pricing based on other information, such as FICO scores, etc; unilateral change in terms, any time, for any reason; retroactive application of higher rates to pre-existing balances; double-cycle billing; unfair balance allocation methods; delayed posting of payments to generate fees; and failure to assess repayment capacity. (Appendix A is a chart comparing the approaches taken with respect to these terms in various Congressional proposals from the 109th and 110th Congresses with the Board's proposals.)

The Board's proposal rejects the recommendations to ban the dubious practices, instead relying exclusively on disclosure. (The exception is the addition of a 45-day advance notice requirement prior to the invocation of a penalty rate, and the extension of the

current 15-day advance notice for unilateral change in terms to 45 days. These are important, and welcome improvements.)

Yet the limits of disclosure are evidenced in the Board's own actions. Take, for example, the double-cycle billing method. It easily meets the unfairness test: There is consumer injury. It is the most expensive of the balance calculation methods for consumers. One sample account analysis calculated a $28.50 finance charge calculated under an average daily balance method compared to a $44.90 finance charge under the two-cycle billing method. Furthermore, it effectively, but surreptiously, eliminates the grace period for many consumers. There is no "countervailing benefit to consumers or competition" whatsoever. As for the third prong? Perhaps this is the best example of disclosure is simply not the answer to all market abuses. The Board proposes to simply give up on disclosures of the balance computation method, because it is simply too complex.[43] That makes it hard to argue that consumers can realistically "avoid" that injury. A similar analysis leads to the same conclusion for most, if not all, of the above practices. If it is too complex to explain, and it adversely affects consumers, then there is little reason to believe that market forces can effectively deal with an abusive practice.

While we recognize and applaud the issuers, like Citi, who have voluntarily stopped doing universal default and "any time, any reason" re-pricing, many other issuers have not. We know well from past experience across many segments of the financial services industry that "best practices" adopted when the spotlight is on, can slip away when that spotlight moves on. And, more to the point, "best practices" are not enforceable.

In both the last Congress and this one, strong legislation has been proposed. Though we welcome the progress in the Board's proposals, we urge Congress to proceed to act where the Board will not.

Notwithstanding our disagreement and disappointment in some of the Board's proposals, we greatly appreciate the care, the thoughtfulness, and the effort of Board and Board staff. While we believe there is much more reform needed, these proposals do reflect progress, for which we thank the Board.

We also thank you for this opportunity to explain our views on this regulatory effort.

ENDNOTES

[1] CRL is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL began as a coalition of groups in North Carolina that shared a concern about the rise of predatory lending in the late 1990s.

CRL is an affiliate of Self Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans. Self-Help has provided over $5 billion of financing to over 50,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across the country, with an annual loan loss rate of under one percent.

[2] For data on the rise in credit card debt among young people, see Tamara Draut and Javier Silva, *Generation Broke: The Growth of Debt Among Young Americans* (Demos, October 2004), www.demos-usa.org. Three in four cardholders between 18 – 24 carried a balance, and the 2001 average credit card balance for that group was $2,985. The study reports that college seniors graduating in 2001 were carrying an average $3,262 in credit card debt.

[3] See, e.g. Cindy Zeldin and Mark Rukavina, *Borrowing to Stay Healthy: How Credit Card Debt is Related to Medical Expenses* (Demos 2007), www.demos-usa.org; David U. Himmelstein, Elizabeth Warren, Deborah Thorne, and Steffie Woolhandler, *Illness and Injury as Contributors to Bankruptcy*, Health Affairs (February 2005); Tamara Draut and Javier Silva, *Borrowing to Make Ends Meet: The Growth of Credit Card Debt in the '90s* (Demos, 2003), www.demos-usa.org

[4] *See, e.g.* Tamara Draut, *The Plastic Safety Net*, 14-17 (Demos and Center for Responsible Lending 2005). A recent report co-authored by former FRB Chairman Alan Greenspan estimates that home "equity extraction" repaid "an average of about $50 billion of non-mortgage consumer debt per year from 1991 to 2005." Alan Greenspan and James Kennedy, *Sources and Uses of Equity Extracted From Homes* p. 9, (Federal Reserve Board 2007-20)

[5] The portions of Regulation Z relevant to credit card disclosures are 12 C.F.R. § 226.4 (rules for determining the *finance charge* – the credit price tag as a dollar amount – for both open- and closed-end credit, and Subpart B, §§ 226.5 – 16. (The proposed revision generally does not address the special rules for Home Equity Lines of Credit, § 226.5b, which will be the subject of a later stage of the review process.)

[6] 15 U.S.C. 1601(a); 109 Cong. Red. 2029 (1963) (remarks of Sen. Douglas), quoted in National Consumer Law Center, *Truth In Lending*, § 1.1.1 (5th Ed. 2003). See also *Mills v. Home Equity Group*, 871 F.Supp. 1482 (D.D.C. 1994) (citing both the public and private purposes of TIL).

Indeed, at the time of the last major overhaul of Reg. Z, following the 1980 Truth in Lending Simplification Act, the FRB staff listed 39 possible goals, in 9 separate categories, against which the effectiveness of TIL could be measured. See 46 Fed. Reg. 20848, 20945-48 (April 7, 1981).

[7] Little has changed about the rules governing the account-opening (or "initial") disclosures, or the periodic statements since they were originally promulgated pursuant to the original 1968 TILA enactment. Though there was a major revision of Regulation Z in 1980 - 81, implementing the Truth in Lending Simplification Act, that focused almost exclusively on the closed-end rules. In 1988, Congress added the requirements for the credit card application and solicitation stage, including the "Schumer Box" tabular disclosures, the rules for which were updated in 2000.

[8] For example, revolving credit caps in California and Nebraska were 18% on the first $1000, and 12% on the balances above $1000. See, e.g. Barbara A. Curran, *Trends in Consumer Credit Legislation*, p. 102

(Univ. of Chicago Press 1966); *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978).

[9] 15 U.S.C. § 1610(b). For example, one congressman noted that the TIL bill "does not give protection similar to that of some State laws which protect the consumer by limiting rates charged on consumer credit." Congressional Daily Edition, Jan. 30, 1968 (Statement of Rep. Eilberg). Indeed, when first introduced, eight years earlier, the proposal was called simply the "Consumer Credit Labeling Bill." S. 2755, 86th Cong., 2d Sess. 1960.) (emphasis added)

[10] *Marquette National Bank of Minneapolis v. First of Omaha Service Corp.*, 439 U.S. 299 (1978).

[11] Ralph J. Rohner and Fred H. Miller, *Truth in Lending*, p. 17 (American Bar Association 2000). Both TIL Simplification and the parity provision were part the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. 96-221; Title V, Part C (parity), Title VI (TIL Simplification).

[12] See, e.g. Robert A. Burgess and Monica A. Ciolfi, *Exportation or Exploitation? A State Regulators' View of Interestate Credit Card Transactions*, 42 Bus. Law. 929 (1987). See also the court's discussion in *Greenwood Trust Co. v. Commonwealth of Mass.*, 776 F. Supp. 21 (D. Mass. 1991), *rev'd* 971 F.2d 818 (1st Cir.1992).

[13] Federal Reserve Statistical Release G.19, http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.html (visited March 23, 2005).

[14] David S. Evans and Richard Schmalensee, Paying with Plastic: The Digital Revolution in Buying and Borrowing, p. 2 (MIT Press 1999).

[15] Federal Reserve Statistical Release G.19, http://www.federalreserve.gov/releases/g19/hist/cc_hist_mt.html (visited March 23, 2005).

[16] David S. Evans, *The Growth and Diffusion of Credit Cards in Society*, 2 The Payment Card Economics Review, 59, 63 (Winter, 2004).

[17] See, e.g. Dean Baker, *Dangerous Trends: The Growth of Debt in the U.S. Economy* (Center for Economic and Policy Research (Sept., 2004), www. cepr.net.; Financial Markets Center, *Flow of Funds Brief*: June 10, 2004 (household debt as share of disposable income rose by 15.8% between 2001 and 2004, to "cross the 110% threshold in final quarter of 2003.)

[18] See National Consumer Law Center, Truth in Lending §1.1.1 (5th Ed. 2003)

[19] This has been successfully addressed by the standardized APR calculation rules for closed-end credit. To the extent that the closed-end APR remains subject to manipulation, it is primarily because of the laundry list of excludable charges in §226.4, rather than the actuarial accounting component of the APR rules.
On the difficulty that increased complexity presents to the disclosure paradigm, see Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, (Payment Cards Center, The Federal Reserve Bank of Philadelphia, January, 2003); William R. Emmons, *Consumer Finance Myths and Other Obstacles to Financial Literacy*, December 8, 2004, conference paper "Consequences of the Consumer Lending Revolution, (St. Louis Univ. School of Law, Dec. 8, 2004) *See also Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*, GAO –06-929 (September, 2006), *available at* http://www.gao.gov/new.items/d06929.pdf.

[20] In 1999, it was 26.2%. Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, p 32. (Payment Cards Center, The Federal Reserve Bank of Philadelphia, January, 2003). Mr. Furletti updated the information through 2005 at CRL request. (E-mail from Mark Furletti, March 5, 2005, on file with

CRL.) *See also* Patrick McGeehan, "Mountains of Interest Add to Pain of Credit Cards," New York Times, p. 1 (Nov. 21, 2004) (fee revenue rose from $6.2 billion in 1990 to $21.5 billion in 2003).

[21] See, e.g. Mark Furletti, *Credit Card Pricing Developments and Their Disclosure*, (Payment Cards Center, The Federal Reserve Bank of Philadelphia, January, 2003); William R. Emmons, *Consumer Finance Myths and Other Obstacles to Financial Literacy*, note 19, *supra*, at 23-26. ("But would consumers not be better off if financial-services providers reduced fees and loan rates rather than spending on financial-literacy that, by all accounts, have minimal impact? The point is, of course, that profit-maximizing financial-services providers really do not want to 'give back' any of their profit margin. Nor do they necessarily desire more financially savvy customers who might shop around more actively or bargain down the terms on the products and services they sell." p. 25-26.)

[22] E.g. *Alan M. White and Cathy Lesser Mansfield, Literacy and Contract* 13.2 Stanford Law & Policy Review 233 (2002); *Re-Examining Truth in Lending: Do Borrowers Actually Use Consumer Disclosures?* 52 Consumer Fin. L. Qtrly Rep. 3 (1998). *See also* Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 Maryland L. Rev. 707 (2006); Matthew A. Edwards, *Empirical and Behavioral Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth i Lending*, 14 Cornell J. Law & Pub. Pol'y 199 (2005).

[23] The proposal, released just two weeks ago, is approximately 400 pages long. Due to both time constraints and space limitations, this testimony addresses only a few highlights gleaned from our preliminary review.

[24] 15 U.S.C. § 1637(c); Reg. Z, § 226.5a.

[25] Reg. Z, § 226.9(c).

[26] *See, e.g.* Testimony of Cindy Zeldin, p. 3, Hearing before the US House of Representatives Committee on Financial Services, Subc. on Financial Institutions and Consumer Credit, Credit Card Practices: Current Consumer and Regulatory Issues." (April 26, 2007)

[27] The operation of one such card, offered by First Premier Bank, is detailed in Comments of the Center for Responsible Lending to the Federal Reserve Board Advance Notice of Proposed Rule-Making, Regulation Z Open-end Review, Docket No. R-1217, pp. 33-36 and Attachment C-1 through C-6.

[28] Proposed 226.5a(b)(16), 226.6(b)(4)(vii).

[29] Proposed OSC 226.5(b)(1)(i)-1(i).

[30] *See generally* Comments to FRB Open-End ANPRM, note 27, *supra* at pp.24-29, Attachment B.

[31] The OCC's rule asserting exclusive enforcement authority even for non-preempted state law was promulgated in 2004. A challenge to the rule is currently pending in the Second Circuit, *OCC v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. 2005), *appeal docketed*, No. 05-5996cv (2d Cir. 2005). The OCC did bring one such enforcement action against a national bank issuing such a special financing card, but only after two state attorneys general had commenced investigations.

[32] *See, e.g.* notes and text accompanying notes 19-22, *supra*.

[33] *See*, Reg. Z, § 226.18(d), (e), which prescribe a simple descriptive phrase for the finance charge and APR.

[34] The "effective" APR is closer to a "fully-loaded" price tag than any other, but, because the Regulation excludes some important charges from the definition of the "finance charge," such as participation fees, §

226.4(c)(4), OTL fees, and "actual, unanticipated" late fees (§226.4(c)(2) and therefore from the calculation of the effective APR, it may still understate the costs. For that reason, consumer groups had recommended that the Board have an "all-inclusive" APR.

[35] § 226.14(e) excludes charges relating to account-opening and participation fees imposed no more than annually. Though "participation fees" are not finance charges, 226.4(c), the Board would include the monthly participation fees in the computation despite that. *See* proposed OSC § 226.14(e)(2)-1,2.

[36] *See* proposed Alternative 1: 226.14(d)(2)(ii) Information on this card's terms is based on information given potential investors, rather than advertisements or disclosures.

[37] Proposal, p. 163, citing the unnamed example of Capital One's "Clarity" card, which has a single charge of $6/$1000 and is currently advertised as a "no interest, 0% APR".

[38] See, e.g. Proposed Rule, pg. 22

[39] 15 U.S.C. § 1637(11) (2005)

[40] *See,* Julie L. Williams and Michael S. Bylsma, *On the Same Page: Federal Banking Agency Enforcement of the FTC Act to Address Unfair and Deceptive Practices by Banks*, 58 Bus. Law. 1243, 1250 note 41.

[41] There are two sources of statutory authority for the Board to regulate unfair or deceptive practices. As to mortgages, it was granted additional authority as part of the Home Ownership Equity Protection Act of 1994, 15 U.S.C. § 1639*l*. However, it also has the authority to issue rules regarding unfair and deceptive practices by banks under the FTC Improvement Act of 1975. Since credit cards are overwhelmingly issued by banks, exercising this rule-making authority would have a tremendous impact on the credit card market.

[42] 15 U.S.C. § 45(n)

[43] *See, e.g.* Proposed Rule, p. 78.

UNFAIR CREDIT CARD INDUSTRY PRACTICES:
Congressional Proposals and FRB Proposed Revision to Regulation Z

Practice / Terms	**Congressional Proposals – 110th Congress** *109th Congress*	**FRB Proposed Relevant Changes** **[Notes: "AS" denotes application & solicitation disclosures; "AO" denotes "account opening disclosures; "PS" denotes periodic statements; and "CT" denotes change in terms notice**
Universal Default	- Ban on universal default trigger --H.R. 1461, H.R. 2146 , S. 1309, *S.2655* - Limit penalty rate to 7% above pre-penalty rate – S. 1395 - Adv. Notice on penalty rate/rate hikes & right to cancel, *S. 499*	- *Mandate 45- day advance notice (up from none)* - Mandate use of term "penalty rate" - Disclose on separate row in table, not combined with "other APRs" on AS & AO - Include brief description of triggering events in the table with the rate - Disclose the balance to which the penalty rate will apply (i.e. retrospective application) - Disclose how long the penalty rate will apply
any time/ any reason or other "risk-related" trigger for penalty rate	-same as above	see above
retrospective application of increased rate to pre-existing balances	Ban -- S. 1395, *S.2655* Right to cancel & freeze old terms on existing balance, H.R. 1461, *S.499.*	-specify the balance to which the penalty rate will apply on AS & AO
unilateral change in terms	*S.2655*	- *Increase advance notice from 15 days to 45 days*
double cycle billing	Ban – S. 1395, H.R. 1461, *S. 499*	- N/A
(un) prompt posting	Mandate date of postmark H.R. 1461, *S. 499, S. 2*	- disclose payment cut-off time on the front of the periodic statement near the due date, if the cut off time is before 5:00 PM (PS)
payment allocation	Apply payment to high-rate balance first – S. 1395	- if an lower introductory rate applies to balance transfer or cash advance and not purchases, there is a grace period on purchases, and the creditor applies payments to the low rate first, this must be disclosed (AS & AO)

OTL fees	Ban if creditor approves – H.R. 1461, *S.499* Ban if limit exceeded do to penalty fee; only once per billing cycle; none in subsequent cycle without additional purchase; offer opt-out of OTL transactions – S.1395	- Disclose in Schumer Box (AS & AO) - Segregated fee disclosure on periodic statement - Year-to-date disclosure of fees on PS
excessive fees / other fee issues	Cap penalty rates at 7% above pre-penalty rate; S. 1395; - Prohibit fees relating to payment (other than late payment) – H.R. 873, 1461, S. 1395 - no compounding interest on fees, S. 1395 - residual interest – S. 1395 -reasonable currency fees, S. 1395 - fees must be limited to amount reasonably related to costs, *S. 2655*	- All transaction fees are finance charges - Exclusive list of charges that must be disclosed on AS & AO; that exclusive list triggers advance change in notice requirements; ; others, including newly invented charges, cannot be disclosed on AS & AO -- disclose at time they may be incurred. - Suggests option to *eliminate* disclosure of the APR that includes fees and rate charges on periodic statements / alternative option is to use more comprehensible explanation , e.g. "fee-inclusive APR" - Year-to-date disclosure of fees and interest on PS
ability to pay / underwriting	Limitations on cards to consumers under 18 – H.R. 1461 - Verification of ability to pay, *S. 2655*	NA

TESTIMONY OF
MARILYN LANDIS
OWNER, BASIC BUSINESS CONCEPTS, INC.
ON BEHALF OF THE
NATIONAL SMALL BUSINESS ASSOCIATION
AT A HEARING BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
U.S. HOUSE OF REPRESENTATIVES
ENTITLED
"IMPROVING CREDIT CARD CONSUMER PROTECTION: RECENT INDUSTRY AND REGULATORY INITIATIVES"
JUNE 7, 2007

Good morning. Chairwoman Maloney and Ranking Member Gillmor, thank you inviting me here today to discuss the impact that various credit-card practices are having on America's small-business community. My name is Marilyn Landis and I am representing the National Small Business Association. I am proud to serve as NSBA's first vice chair as we celebrate our 70th year of small-business advocacy, and continue our long-standing tradition of working in a nonpartisan manner to promote pro-small-business policies. In addition to my leadership role within NSBA, I am the owner of Basic Business Concepts, a consulting and financial management company serving small businesses primarily in Pennsylvania and Ohio.

Prior to starting Basic Business Concepts, I spent 30 years working for and with commercial lenders, banks and small businesses throughout western Pennsylvania. I worked for three of the largest U.S. Small Business Administration (SBA) lenders in the country and have continued working with my clients on securing SBA loans and myriad other sources of capital. After 36 years of working with small businesses, the one thing I can tell you without hesitation is that it is not easy to start or develop a business in America. Entrepreneurs must overcome a host of obstacles to create and expand their businesses—and the practices of the credit card industry are not the least among them.

Small-Business Challenges in Financing

Access to capital is one of the largest obstacles facing America's small businesses, hindering both aspiring and thriving entrepreneurs. In fact, the small-business members of the National Small

MARILYN LANDIS
NATIONAL SMALL BUSINESS ASSOCIATION

Business Association recently identified access to capital as one of the top-10 issues impacting their companies. Many small and startup businesses lack the assets necessary for traditional bank loans. Smaller loans are generally less-profitable for banks, and typically have a higher default rate. The increased usage of personal credit ratings for business owners has further exacerbated the problem. Additionally, ongoing bank consolidation has resulted in fewer community banks and fewer character-based loans.

One of the biggest barriers to small-business financing is debt secured by equity in fixed assets. Many small-business owners do not have the kind of equity required by banks to acquire a sizeable loan. This gap in debt-equity financing primarily hinders both startup businesses and growing businesses. An entrepreneur wishing to open any business would face significant barriers to financing, as home ownership (if the entrepreneur owns a home) rarely meets the equity requirements for receiving a larger commercial loan. The small-business owner seeking to expand his or her business or hire additional employees faces the same challenges.

Small-Business Reliance on Credit-Card Financing

Into this access to capital vacuum, a new capital issue has sprung to the forefront: an increased reliance on credit cards. Starting in the early years of this decade—when a multitude of banks tightened their lending standards—many small-business owners have been forced to turn to credit cards as their primary source of working capital. Bank regulators require business borrowers to have either equity in hard assets or historic cash flow to support their loan requests. Rapidly growing businesses that are not traditional brick and mortar, like mine, have neither. We are forced to use bank credit lines which, if not secured with equity in a home, are increasingly credit card accounts. As such, these loans are subject to credit card regulations, which permit significantly higher and more volatile rates and payment structures. I can personally attest to this phenomenon, as not long ago I applied for a "line of credit" with Wells Fargo and instead received a new credit card.

Rapidly-growing service and technology companies do not want to rely on credit card debt—they are forced to. According to a nationwide survey of small- and mid- sized small business owners, recently commissioned by the National Small Business Association, credit cards are a primary source of financing for America's small businesses. In fact, 44 percent of small-business owners identified credit cards as a source of financing that their company had used in the previous 12

months—more than any other source of financing, including business earnings. In 1993, only 16 percent of small businesses owners identified credit cards as a source of funding they had used in the preceding 12 months. This dramatic increase does not only represent emergency or short-term usage. Of the small-business owners who use credit cards as a source of funding, 71 percent report carrying a balance month-to-month. This is up from 64 percent in 2000. Thirteen percent of small-business owners are carrying a balance of more than $25,000, and 36 percent are carrying a balance more than $10,000.

It is important to note that small-business owners are not turning to credit cards to finance their businesses because they think they are getting a good deal. In fact, among those using credit cards, 53 percent say that the terms of their cards have gotten worse over the last five years.

Why should the small-business community's increased reliance on credit cards and their sense of worsening credit-card terms be of interest to this subcommittee? Put simply, small businesses are the engine of the U.S. economy and the backbone of the communities you represent. Small businesses comprise 99.7 percent of all U.S. employer firms and more than half of all private-sector employees. Over the last decade, they have generated 60 to 80 percent of all net, new jobs in the country. They are responsible for more than 50 percent of nonfarm private gross domestic product. In short, what harms America's small businesses harms America's economy.

The billions of dollars generated from outlandish retroactive interest rates hikes, the escalating imposition of undisclosed fees, and unilateral and unforeseen interest-rate increases is money diverted from economic development. For small businesses, it means less money to advertise or invest in new equipment or hire new employees. A third of small- and mid-sized businesses say that they would hire additional employees if more capital were available to them. More capital might be available if so much of it was not being siphoned off by the unacceptable business practices of the credit-card industry. In order to address the practices that are making running a small business increasingly difficult and hindering the economic development of the nation's small businesses, NSBA supports credit-card reform.

Recommendations

NSBA supports the enactment of the new credit card regulations recently proposed by the Federal Reserve Board. Improved disclosure—which must not be construed as simply *more* disclosure—

is of paramount importance to the small-business community. We are businesspeople, more than capable of playing by the rules—but the rules must be made known, and they must be consistent and predictable.

Let me detail a personal incident that demonstrates the inconsistent and unpredictable nature of current credit card practices. I have an Advanta credit card for which I carried an average daily balance of $5,506.22, at 2.99 percent. In November 2006, I received a cash advance—a cash advance, incidentally, for which I paid a $50 fee, interest on the fee, and 11.49 percent interest on the advance—from the card in the amount of $14,317.77, at 11.49 percent. There was no other activity and when my $455 bill arrived, I paid it on time. Therefore, I was surprised to see my cash advance interest rate swell from 11.49 percent to 20.01 percent in my December bill. Equally surprising was that my average daily balance, for which I was paying 2.99 percent, had dropped to $1,779.86, while the rest of my outstanding balance, for which I was paying 19.99 percent, jumped up to $17,333.50 with no explanation. One can imagine how difficult it is to adhere to a business plan with this sort of unpredictability lurking in every expenditure.

This unpredictability does not end with unexpected interest-rate hikes. Let me share with you another story—this one dealing with a Bank of America credit card I opened in November 2006. For this card, Bank of America promised a zero-percent interest rate until September 2007. Unfortunately, it did not quite make it. I received my December bill on Jan. 3, 2007. It was dated Dec. 26, 2006—the day after Christmas—and due on Jan. 20, 2007, which was only 17 days away. I mailed my payment on Jan. 5. Bank of America said they received my payment on Jan. 22 so I was charged a $49 late fee. Oh, and my zero-interest rate credit card suddenly sported a new and improved 22.24 percent interest rate. Thankfully, I am only being charged $1 a month on my existing balance for this card, but any new expenditure is being charged at the new interest rate and any remaining balance will charged at this rate come September. In the meantime, I am stuck with a card that I cannot and will not use, while the mere existence of the card hinders my ability to garner additional capital.

There is one predictable aspect of my Bank of America card: the due dates are never the same, fluctuating by five days in the last seven months, from 12/19/06 to 1/20/07 to 2/20/07 to 3/23/07 to 4/20/07 to 5/21/07 to 6/19/07. The statement cut-off has remained the same during this time. The same can be said of my MBNA card, since it was sold to Bank of America. Previously, the

due date was the 27th of the month. Between December 2006 and April 2007, the due dates for this card fluctuated greatly, from 12/28/06 to 1/27/07 to 2/24/07 to 3/22/07 to 4/22/07. Again, the statement cut-off has remained the same during this time. While I will stop short of calling this willful inconsistency, however it is characterized it makes running a business more challenging and perilous.

As welcome and necessary as the improved disclosure practices at the heart of the Fed's proposal are, they are not enough. Adding more pages to the typical encyclopedic credit card contract (which, on average, is now longer than 30 pages, according to the *Wall Street Journal*) will do little to assist most small business. America's entrepreneurs are not naïve or uniformed consumers. They are accustomed to dealing with myriad complex financial and regulatory frameworks. The current rules—such as they are—governing the credit-card industry are simply stacked against them.

Eliminate Universal Default

Starting in 2000, credit card issuers began increasing a credit card holder's interest rate if the cardholder was late on an unrelated payment to a different credit card, a utility company, or a mortgage lender, to name a few. This practice, known as "universal default," is particularly injurious to small-business owners, who have intermingled personal and professional finances as they increasingly rely on personal credit cards to finance their businesses. In practice, universal default meant small-business owners that were a day late paying their power bill might see the interest rate on their business credit card soar to nearly 30 percent.

In 2004, the Office of the Comptroller of the Currency issued a guidance to banks urging them to disclose this practice in promotional materials. This guidance, which included language warning of the risks of using a universal default policy, was fairly successful in motivating U.S. credit-card issuers to cease the practice. According to a September 2006 report by the Government Accountability Office (GAO), however, three of the 28 most popular cards still employ a universal default policy. This GAO report also found that four other of the most-popular 28 cards are seeking to reinstate universal default, but are trying to do so under the auspices of a "change-in-terms," which unlike the automatic increase previously done with universal default can require prior notification.

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While Regulation Z of the *Truth in Lending Act* requires that affected cardholders be notified in writing of any proposed changes in rate terms at least 15 days before such change becomes effective—and the Federal Reserve proposed increasing this notification period to 45 days—this "opt-out" option does little to help small businesses who are carrying large month-to-month balances. Most small-business owners forced to turn to credit cards to finance a capital expenditure or an expansion of their business would be hard pressed to immediately pay off their balance with a 15, or even a 45, day notice. NSBA urges Congress to codify language preventing banks and credit-card issuers from using universal default increases on credit cards unrelated to a particular late payment.

Eliminate Double-Cycle Billing

The aforementioned GAO report found that two of the six largest credit-card issuers employ a billing technique known as double-cycle billing, wherein the issuers consider two billing cycles when assessing interest on custumers that move from non-revolving to revolving status. In other words, a consumer who begins with no balance and pays off some but not all of his or her new expenditures is forced to pay interest on the entirety of the original bill, even that which previously had been subject to an interest-free period.

Eliminate Retroactive Application of Interest Rate Increases

As exorbitant as the penalty rates most credit-card issues charge may appear, the small-business members of NSBA are not advocating a cap—although America's small-business community certainly would welcome a voluntary reduction in penalty rates or an enlarged threshold for their application. Jumping to the average default rate of 27.3 percent because of one late payment or slightly exceeding one's credit limit seems an awfully stiff penalty. Having said this, NSBA does support eliminating the retroactive application of penalty rates. This effectively increases the purchase price of products and services for which consumers are already committed. This *ex post facto* application is contrary to basic market principles and undermines business plans. As Travis Plunkett, legislative director of the Consumer Federation of America, recently testified before this committee, "There is no other industry in the country that is allowed to increase the price of a product once it is purchased."

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NATIONAL SMALL BUSINESS ASSOCIATION

Conclusion

America's small-business owners are not in the habit of advocating the passage of increased federal regulations, preferring free enterprise and market solutions, but there is no functionally-free credit-card market. One of the basic tenets of the free-market capitalism is the sanctity and insolubility of contracts, but somehow the credit-card industry has managed to insulate itself from adherence to this basic principle, retaining the right to unilaterally change the conditions of their contracts.

Free market competition also is based on informed consumers, but the business practices of the credit card industry appear geared more towards obfuscation than illumination. The aforementioned GAO report found that credit-card disclosure statements were written at too-high a level, displayed poor organization and formatting, and were filled with extraneous, non-pertinent information. As Professor Elizabeth Warren recently testified before the full committee, "In a perfectly competitive market, both firms and consumers have the information they need to make sound economic decisions. Because these tricks and traps are effectively hidden from customers—invisible until they bite, that is—credit card issuers face no economic penalty in the marketplace for including them in card agreements."

The free-market system also relies on actual competition, but there is no longer real competition in the credit card industry. By 2006, the top three card issuers controlled more than 61.8 percent of the market (understood as their proportion of outstanding credit card debt) and the top 10 issuers controlled 88.1 percent in 2004, according to Professor Robert Manning.

The small-business community is not opposed to the credit-card industry nor does it begrudge it the $109 billion in revenue it made in 2005. In fact, as I previously outlined, the small-business community is increasing reliant on credit cards for its very existence. This is why Congress must act to protect the interests of America's small businesses, while still allowing the credit-card industry ample opportunity to turn a profit. NSBA strongly encourages both the administration and Congress to fully support small businesses as the true centers of growth in the U.S. economy and take the lead in ensuring that egregious credit-card practices are not restricting small-business growth.

I thank you for your time and welcome any questions.

Testimony of the

U.S. Public Interest Research Group

Edmund Mierzwinski
Consumer Program Director

Oversight Hearing On
Abusive Credit Card Industry Practices

Before the Subcommittee
On Financial Institutions and Consumer Credit
Of the Financial Services Committee,
U.S. House of Representatives
Honorable Carolyn Maloney, Chair

7 June 2007

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 1

Chair Maloney, ranking member Gillmor, members of the committee:

Thank you for the opportunity to offer U.S. PIRG's views on abusive credit card industry practices. We commend you for having this timely hearing. I am Edmund Mierzwinski, Consumer Program Director of U.S. PIRG. As you know, U.S. PIRG serves as the federation of and national lobbying office for state Public Interest Research Groups. PIRGs are non-profit, non-partisan public interest advocacy organizations with offices around the country.

SUMMARY:

Owning a credit card company is truly a license to steal. The credit card industry, for years easily the most profitable form of banking according to Federal Reserve Board annual reports to Congress, has seen its profits grow to new heights on the wings of revenue derived from punitive APRs of 32% or more, imposition of late and over-the-limit fees of up to $39 issued on a repeat basis for purported violations that may not have been violations and from the cumulative effects of deceptive disclosures of the true cost of credit, especially in the case of minimum monthly payments. The failure to adequately disclose the cost of credit encourages the most at-risk members of the customer base to carry large unpaid balances at unaffordable interest rates and leaves them in a cycle of perpetual debt. Concentration of the industry has resulted in a tight oligopoly where the largest and most powerful players act with impunity. Once vigilant state enforcers have been de-fanged; private enforcement is hampered by unfair binding mandatory arbitration and federal agencies merely aid and abet bank practices, instead of regulating them. The credit card industry operates without fear of either market or regulatory action to temper its excesses, at the expense of the public's welfare.

While we concur 100% with the comprehensive analysis offered today by our fellow witness Kathleen Keest of the Center for Responsible Lending of proposed Federal Reserve Board changes to Truth In Lending Act (TILA) disclosures, we note that her testimony's main point is to stress the general limitations of the disclosure approach as a restraint on unfair or deceptive practices that leave vulnerable consumers trapped in a cycle of debt. The Congress must act immediately to restore state and local enforcement efforts over national banks, make it easier for consumers to enforce the law themselves and must also explicitly ban the industry's sharpest and most egregious practices.

As the CRL testimony explains, some of what the Fed proposes is good, some of it is bad, but on the whole, disclosure is only a small part of the solution. It is not a substitute for substantive consumer protections, including prohibitions on the practices that even the industry's name brand, supposedly blue chip players, engage in. Throughout, these players have been aided and abetted by actions of the Office of the Comptroller of the Currency (OCC), which misplaces the self-serving doctrine of federal preemption as somehow being above the public interest goal of ensuring that taxpayer-guaranteed financial institutions treat the American public fairly.

It is important to recognize that when TILA was enacted in 1968 its federal disclosure rules were buttressed by a framework of strong, enforced state consumer protection laws. Then, the Supreme Court's 1978 Marquette (holding that credit card companies could export high interest rates nationwide from their own home states) and 1996 Smiley (extending that holding to include fees) decisions encouraged both the consolidation of the industry and its move into a few safe harbor states. Then, following enactment of the 2004 OCC rules further preempting state enforcement

authority, the extremely concentrated credit card industry increased its ability to engage in a growing and wide number of unfair, anti-consumer practices. Today, it operates in a deregulated marketplace where state enforcement efforts have been shut down and state consumer laws have been preempted. Of course, the industry happily complies with the laws of those safe harbor states from which the OCC and other pliant federal regulators allow it to operate nationwide under only their federal "enforcement." The OCC and other federal bank regulators have largely ignored the industry's unfair practices while their regulatory and legal actions have only encouraged them. The OCC's few consumer enforcement actions have largely been limited to efforts against obscure institutions accompanied by modest guidance letters for the industry as a whole.

Nor can consumers protect themselves in this marketplace. Unfortunately, due to the widespread use of binding mandatory arbitration clauses in credit card and indeed all bank account contracts, private consumer enforcement is nearly impossible.

Numerous credit card complaints to consumer groups allege that companies raised rates when bills were paid on time. Others allege that rate increases were due to alleged late payments to someone else; yet, the banks have told other Congressional panels that they do not engage in this practice, known as universal default. Worse, the firms are allowed to change the rules at any time, for any reason, including no reason.

The real solution is not disclosure. The solution, in our view, is to ban the most unfair practices, reinstate the authority of state regulators to enforce their consumer protection laws, and to prohibit unilateral changes of terms clauses and mandatory arbitration clauses.

(1) INTRODUCTION TO UNFAIR CREDIT CARD PRACTICES

The most common unfair credit card company practices include the following:

- Unfair and deceptive telephone and direct mail solicitation to existing credit card customers – ranging from misleading teaser rates to add-ons such as debt cancellation and debt suspension products, sometimes called "freeze protection," which are merely the old predatory product credit life, health, disability insurance products wrapped in a new weak regulatory structure to avoid pesky state insurance regulators[1];
- Increasingly, the use of unfair penalty interest rates ranging as high as 30-35% APR or more, including, under the widespread practice of "universal default," imposing such rates on consumers who allegedly miss even one payment to <u>any</u> other creditor, despite a perfect payment history to that credit card company;
- Imposing those punitive penalty interest rates retroactively, that is on prior balances, further exacerbating the worsening levels of high-cost credit card debt;
- Imposing higher late payment fees, which are often levied in dubious circumstances, even when consumers mail payments 10-14 days in advance;
- Using a variety of mail trickery, such as changing the due dates of monthly bills, making the due date a Sunday but not posting on the weekend; shortening the period between when a bill is mailed out and when that bill is due, etc.;
- Increasing the use of aggressive and deceptive marketing to new customer segments, such as college students with neither a credit history nor an ability to repay and to persons with previous poor credit history;

- Making partnerships with telemarketers making deceptive pitches for over-priced freeze protection and credit life insurance, roadside assistance, book or travel clubs and other unnecessary card add-ons;
- Imposing unfair, pre-dispute mandatory arbitration[2] as a term in credit card contracts to prevent consumers from exercising their full rights in court; and the concomitant growing use of these arbitration clauses in unfair debt collection schemes;
- The failure of the industry to pass along the benefits of what, until recently, were several years of unprecedented the Federal Reserve Board interest rate cuts intended to provide economic stimulus, through the use of unfair floors in credit card contracts.
- Using the clause "Any term can be changed at any time for any reason, including no reason" in credit card contracts as allowed by Delaware and other safe harbor state laws.

The practices described above can be illustrated with the following examples:

- Banks entice consumers to open or continue credit card accounts with promises of a fixed interest rate on unpaid balances on purchases. Thereafter, they unilaterally increase the so-called fixed rate, and may change it to a variable rate[3].
- Banks bait and switch credit card consumers with teaser offers promising a low introductory interest rate on additional credit card debt and the consumer's pre-existing (regular) interest rate thereafter. But after individual consumers accept the offer and increase their unpaid balance, banks unilaterally and without notice raise the consumer's regular interest rates because now, the individual consumer's debt is allegedly "too high."
- Banks ignore consumers' disputes to charges, which, according to banks themselves, need not be paid pending resolution. Instead, banks unilaterally use such non-payment to charge late fees and raise interest rates.
- Banks reduce credit limits of consumers on their credit card accounts unilaterally and without advance notice, and do so in such manner and to such an extent as to intimidate consumers into abandoning their legitimate objection to charges.
- Banks fail to adequately inform consumers in advance of a proposed increase in interest rate based on the individual consumer's purportedly high debt or other information in such consumer's credit report. Thereby, consumers have no opportunity to avoid the increased interest rate, and are saddled with significant additional interest payments without advance notice.
- Credit card companies use low, short-term "teaser rate" introductory APRs to mask higher regular APRs. The introductory APR is one of the primary tools used to market a card, and it usually appears in large print on the offer and envelope. In a PIRG study, of the 100 card offers surveyed, 57 advertised a low average introductory APR of 4.13%. Within an average of 6.8 months, the regular APR shot up 264% to an average regular APR of 15.04%. The post-introductory APR, as well as the length of the introductory period, were not prominently disclosed.
- Important information is disclosed only in the fine print of the offer. For example, the fine print of most offers states that if an applicant does not qualify for the offered card, s/he will receive a lower-grade card, which usually has a higher APR and punitive fees (a practice called "bait and switch"). The fine print is easy to overlook, and as a result, a consumer may receive a card that s/he did not want.

- Free does not mean free. The "free" offers that are advertised with many cards are not usually as impressive as they appear. Most have significant restrictions or hidden costs, such as enrollment fees or expiration dates.
- Companies are failing to disclose the actual APRs of cards. Increasingly, credit card companies are quoting a range of APRs in offers rather than a specific APR, a practice called "tiered" or "risk-based" pricing. These ranges are frequently so wide as to be utterly useless to consumers.
- Fine print fees for cash advances, balance transfers, and quasi-cash transactions such as the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print, where consumers can easily miss them. Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount.
- Card companies now impose multiple APRs – one for balance transfers, one for purchases and one for cash advances, for example – but apply monthly payments first to the balance with the lowest APR, ensuring that it will take the longest to pay off the card.

Another way to look at these problems is to look at an example: In a recent court complaint against a credit card company, a consumer attorney pleaded the following facts:

> On June 17, 2002 the balance owed on the consumer's account was $702.00. On June 18, 2002, the bank added a $59 club membership fee that caused the consumer's account to exceed his credit limit by $11 (the balance owed was $761 and the credit limit was $750). From June 2002 until August 2004, even though the consumer made timely monthly payments each month, the bank added $435 in over-limit fees to this account and $495 in late charges on this account.

This consumer responded to some bank-initiated telemarketing pitch or bill insert to join some sort of a membership club, then the bank allowed him to go over his limit to complete the transaction for a purchase it itself had initiated, then that triggered an ongoing cascade of repeated late and over-the-limit fees that have caused the consumer to end up in a cycle of rising debt even though he no longer uses the card. This example, multiplied by millions of consumers, gives you an idea of how credit card debts have piled up in this country.

(2) PRIOR TO ENACTMENT OF THE 2004 OCC RULES, STATE AND LOCAL ENFORCERS HELPED POLICE THE MARKETPLACE AND BY THEIR ACTIONS ENCOURAGED OCC TO DO SO ALSO

In the late 1990s, consumer advocates and state enforcers and even federal regulators began to notice an increase in unfair credit card practice complaints. Even the Treasury Department's Office of the Comptroller of the Currency (OCC), no consumer protector, began to escalate the appearance of its efforts against unfair credit card company practices at the time. Although it did not take any public actions against any well-known major institutions, it did file enforcement actions against a few obscure, small fringe institutions after one case against an albeit large, but relatively upstart mono-line[4] credit card bank, Providian (now part of Washington Mutual (WAMU)).

The OCC's 2000 action against Providian was only after the San Francisco District Attorney and the California Attorney General initiated earlier and widely-praised enforcement actions. As we list below, a number of states aggressively took action against credit card companies in this time frame as well. Most of these state and local actions would generally be prohibited now, after promulgation of the 2004 OCC preemption rules. More recently, following intense criticism, including from this committee, the OCC has consolidated a summary of its actions onto one website to make its efforts appear more comprehensive[5]. Over the last four years, OCC has also issued a series of modest regulatory guidances admonishing banks against certain common unfair practices, but has not imposed any recent publicly-disclosed civil penalties.

(A) Despite Massive Numbers of Complaints, OCC Engaged In No Publicly Disclosed Self-Initiated Actions Against Any Top Ten Banks

In 2006, as in previous years, 39% of OCC's complaints were against credit card banks.

According to the GAO:

> "from 2000 through 2004, credit cards were the most common product involved in complaints addressed by OCC, FDIC, and the Federal Reserve. According to officials from OCC and FDIC, complaints about credit cards will continue to remain high because consumers have multiple credit cards and use them frequently. Credit card complaints accounted for, on average, about 39 percent of all complaints handled by OCC, from 2000 through 2004. For FDIC, the amount was nearly 29 percent and for the Federal Reserve, approximately 40 percent."[6]

Yet, even the GAO explains that the large number of credit card complaints to OCC versus to other regulators is because it supervises so many large banks. Yet, to our knowledge, the OCC has not imposed public penalties or sanctions on any of the nine of the current "Top Ten" banks under its regulation[7], even though most advocates believe the sharp practices are endemic to the industry, including its largest players. Curiously, around the same time that the Providian case was being investigated, several private lawsuits were settled against First USA/Bank One (a Top Ten issuer at the time, now part of Chase). According to a FOIA request U.S. PIRG filed at the time, complaints to the OCC against First USA/Bank One dwarfed all others to the OCC. Yet, to our knowledge, the OCC never imposed penalties against that bank. The complaints were largely concerning disputes over timely payments charged as late.

Further, as Professor Art Wilmarth[8] testified before this subcommittee in April 2007:

> The OCC's record is similarly undistinguished with respect to consumer enforcement actions taken against national banks for violations of consumer protection laws. Since January 1, 1995, the OCC has taken only thirteen public enforcement actions against national banks for violations of consumer lending laws. With two exceptions, all of those actions were taken against small national banks... Since January 1, 1995, the OCC has not issued a public enforcement order against any of the eight largest national banks for violating consumer lending laws. In contrast to this absence of public enforcement action by the OCC against major national banks, state officials and other federal agencies have issued numerous enforcement orders against leading national banks or their affiliates – including Bank of America, Bank One, Citigroup, Fleet, JP Morgan Chase, and US

> Bancorp – for a wide variety of abusive practices over the past decade, such as predatory lending, privacy violations, telemarketing scams, biased investment analysis, manipulative initial public offerings, and allowing hedge funds to engage in late trading and market timing in bank-sponsored mutual funds. [Citations omitted.]

(B) Meanwhile, State Attorneys General Had Aggressively Enforced The Law (Prior To Issuance of the 2004 OCC Rules)

Of course, state Attorneys General, always the top consumer cops on the beat, had long been aggressively pursuing crime and other anti-consumer practices in the credit card suites. Some late 20th- early 21st century actions by state Attorneys General included the following.

- Beginning in 1999, the Minnesota Attorney General and other states settled multi-million dollar claims against U.S. Bank for its practice of allowing telemarketers access to its credit card customer records for the purpose of deceptively marketing add-on products including credit life insurance, roadside assistance packages, and other gimmickry billed to consumers who did not even give their credit card numbers and had no knowledge that they had allegedly placed orders or would be billed for any product.
- In December, 2002, 28 states and Puerto Rico settled a case with the aforementioned First USA (a unit of Bank One, which is now part of JP Morgan Chase after its acquisition of Bank One) "that will provide new protections against misleading telemarketing campaigns for more than 53 million credit card holders. First USA Bank N.A. - the largest issuer of Visa credit cards - and also known as Bank One Delaware NA, has agreed to implement broad reforms in its relationships with third-party vendors to ensure that non-deceptive marketing campaigns are used in soliciting the bank's credit card holders. Specifically, under the agreement, First USA must prohibit vendors from engaging in deceptive solicitations."[9]
- In February 2002, 27 states negotiated an agreement for Citibank, then the nation's largest credit card issuer, to stop deceptive practices in the marketing of similar tawdry add-on products. "The states raised concerns that the marketing practices of Citibank's business partners were deceptive and often resulted in consumers being charged for products and services - such as discount buying clubs, roadside assistance, credit card loss protection and dental plans - that they had no idea they agreed to purchase."[10]
- Prior to issuance of the 2004 OCC rules, numerous state Attorneys General, including Minnesota[11], Texas, West Virginia, New York and others had filed actions against the large sub-prime credit card company Cross Country Bank for its deceptive and predatory practices when marketing to consumers with impaired credit histories. The Attorney General of Minnesota's complaint alleged use of racial, derogatory and abusive epithets in the bank's contacts with customers[12]. The Attorney General of Pennsylvania had this to say in 2004: "Instead of helping consumers as promised, the defendants actually pushed cardholders further into debt when they used the credit cards. Those who failed to make the payments, were subjected to a barrage of abusive, harassing collection practices that included the use of profanity and multiple calls to consumers' homes or offices."[13]
- In January 2005, Minnesota Attorney General Mike Hatch filed an unfair practices suit against Capital One Bank and Capital One F.S.B. for using false, deceptive and misleading television advertisements, direct-mail solicitations, and customer service telephone scripts to market credit cards with allegedly "low" and "fixed" interest rates that, unlike its competitors' rates, supposedly will never increase. Capital One, of course, is one of the nation's largest credit card

companies, with an aggressive advertising campaign urging consumers to put a Capital One card in their wallet and avoid the other companies, generally portrayed by Capital One as Vikings, Visigoths or other sorts of plundering barbarians. Other states, including West Virginia, also announced parallel investigations of Capital One. West Virginia, this month, had to file suit to enforce its subpoenas against the bank.[14] In 2006, Minnesota settled with Capital One.[15]

(C) After State and Local Prodding, The OCC Began To Awaken

- In 2000, the tiny San Francisco District Attorney and the California Attorney General[16] began an investigation later joined by what many claim was an embarrassed and late to the party OCC, which resulted in imposition of a minimum of $300 million in civil penalties and a restitution order against Providian for deceptive marketing of mandatory credit life insurance, known as freeze protection, and other violations. The OCC, not generally known for hyperbole in defense of the consumer, said the following: "We found that Providian engaged in a variety of unfair and deceptive practices that enriched the bank while harming literally hundreds of thousands of its customers[17]."
- In 2001, the OCC imposed multi-million dollar penalties and a restitution order against Direct Merchants' Bank its practice of "'downselling' consumers by prominently marketing to consumers one package of credit card terms, but then approving those consumers only for accounts with less favorable terms, and touting the approved account in a fashion designed to mislead the customer about the fact he or she had been 'downsold'[18]." The OCC subsequently brought a few cases against other obscure national banks between 2001-2003.[19] Apparently, no penalties have been imposed since.

(D) Some Success For Private Plaintiffs In That Time Frame

While the rise in state enforcement was stymied by imposition of the OCC rules in 2004, some private plaintiffs have always attempted to enforce the law. In the early years of this century[20], several private class action lawsuits were also settled against other large banks for abusive practices, such as cases against Bank One/First USA for charging consumers late fees, even when they pay on time. In addition, in 2003, the 3rd Circuit found that Fleet Bank had violated the Truth In Lending Act (TILA) when it promised Paula Rossman a no-annual-fee credit card and changed the terms immediately, less than a year after she'd obtained the card, even though Rossman had not violated any of the contract's terms by paying late, going over her limit, or anything else. The court described the essential problem this way:

> A statement, therefore, that a card has "no annual fee" made by a creditor that intends to impose such a fee shortly thereafter, is misleading. It is an accurate statement only in the narrowest of senses--and not in a sense appropriate to consumer protection disclosure statute such as the TILA. Fleet's proposed approach would permit the use of required disclosures--intended to protect consumers from hidden costs--to intentionally deceive customers as to the costs of credit.[21]

Of course, Rossman highlights one of the critical hypocrisies and significant flaws in the federal un-regulation of the credit card marketplace, where credit card contracts are take-it-or-leave contracts of adhesion imposed on consumers that purport to allow the bank to make any changes at any time for any reason. As the court quotes Fleet's contract in Rossman:

> We have the right to change any of the terms of this Agreement at any time. You will be given notice of a change as required by applicable law. Any change in terms governs your Account as of the effective date, and will, as permitted by law and at our option, apply both to transactions made on or after such date and to any outstanding Account balance.[22]

In summary, then, it has become almost impossible for state enforcers to act against large credit card companies and it has also become difficult for private enforcement to police the marketplace due to mandatory arbitration clauses limiting consumer efforts. Efforts need to be taken to improve the ability of state and private enforcers to police the credit card market.

(3) ABUSIVE CREDIT CARD INDUSTRY PRACTICES ON CAMPUS AND TO NEW CUSTOMER POPULATIONS

Having saturated the working adult population with credit card offers, credit card companies are now banking on new markets: college students and others who have never had, or had only limited access to, credit cards. See, for example, "Eliminating Barriers to Credit and the Challenges of Credit Card Use for Latino Consumers," testimony to the Senate Banking Committee summarizing a recent report by the National Council of La Raza,[23] which details a variety of challenges Latino credit card consumers face, including greater vulnerability to scams, reliance on higher-priced cards and difficulty working with the OCC's "obscure consumer complaint system."

As for college students, under regular credit criteria, many students would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they grow older. Nellie Mae, the student loan agency, found that 78% of undergraduate students had credit cards in 2000. Credit card companies have moved on campus to lure college students into obtaining cards. Their aggressive marketing, coupled with students' lack of financial experience or education, leads many students into serious debt. According to a recent PIRG study, the Burden of Borrowing, credit card debt exacerbates skyrocketing student loan debts. That 2002 study found that thirty-nine percent (39%) of student borrowers now graduate with unmanageable levels of debt, meaning that their monthly payments are more than 8% of their monthly incomes. The study also found that student borrowers were student borrowers were even more likely to carry credit card debt, with 48% of borrowers carrying an average credit card balance of $3,176.[24]

In 2004, Maryland PIRG and the Maryland Consumer Rights Coalition releasing a study of credit card marketing practices on the state's college campuses. Among the highlights of Graduating Into Debt[25] were the following:

- Credit card vendors are setting up tables on some campuses in violation of university policies prohibiting or limiting tabling.
- At least two schools currently sell their student lists (names, addresses and telephone numbers) to credit card issuers.
- Several schools have exclusive marketing agreements with one credit card issuer for which they receive financial compensation.
- Only one school that allows on-campus marketing had a comprehensive written policy specifically governing credit card marketing.

Similar results are found in other states by other investigators. Some universities have banned or regulated card marketing on campus.

Previously, a PIRG study, the **Credit Card Trap,** released in April 2001, included a detailed study of the worst credit card practices. The report was released at the same time as we announced a detailed fact sheet available at the PIRG website truthaboutcredit.org.[26] Because Consumer Action[27] releases annual survey data, I will not go into details on the report's survey results. The key findings of a year 2000 survey of 100 credit card offers included in "The Credit Card Trap" are available online[28].

(4) BRIEF PROFILE OF THE CREDIT CARD INDUSTRY:

Credit card lending is the most profitable form of lending, according to the Federal Reserve's most recent report to Congress in 2006:

> Although profitability for the large credit card banks has risen and fallen over the years, credit card earnings have been consistently higher than returns on all commercial bank activities. For example, for all commercial banks, the average return on all assets, before taxes and extraordinary items, was 1.94 percent in 2005, well below the returns on credit card activities in that year.[29]

In recent years, those profits have been augmented by rapid increases in fee income.

There may be, as the industry witnesses will trumpet, some 6,000 credit card issuers. But there are only ten that matter. The actual marketplace is highly concentrated.

Since 1980, revolving debt, which is largely credit card debt, increased from just $56 billion to well over $800 billion, according to recent Federal Reserve data[30]. Approximately 55% of consumers carry balances (the rest are convenience users) meaning consumers with credit card balances average $10-12,000 each in total credit card and revolving debt.[31]

Credit card companies have increased profit by increasing the amount of credit outstanding by decreasing cardholders' minimum monthly payments, increasing interest rates, and piling on enormous fees. Until very recently, credit card companies engaged in a practice of decreasing the minimum percentage of the balance that cardholders must pay in order to remain in good standing. Today, despite recent changes mandated by the OCC to require that minimum payments reduce principal by at least 1%, most companies still require a minimum monthly payment of only 2% or 3% of the outstanding balance. As a result, cardholders who choose to pay only the minimum each month take longer to pay off their balances, paying more interest in the process. In its recent guidance, the OCC admonished banks to raise these minimum payment levels only modestly. "The required minimum payment should be sufficient to cover finance charges and recurring fees and to amortize the principal balance over a reasonable period of time."[32] According to a U.S. PIRG analysis, a consumer carrying just $5,000 of debt at 16% APR would take 26 years to pay off the balance if she only made the 2% requested minimum payment, even if she cut the card up and never used it again.

And, according to the Fed, industry aggressively seeks new customers: "An industry source indicates that in 2004, 71 percent of US households received an average of 5.7 offers per month, or 58 offers/year.[33] During 2004, US households received an estimated 5.23 billion credit card offers, up 22% compared to 2003 and exceeding the previous record of 5.01 billion offers set in 2001.[34]"

(5) POLICY RECOMMENDATIONS OF U.S. PIRG TO ADDRESS ABUSIVE CREDIT CARD PRACTICES:

Prohibit Universal Default: Enact legislation such as H.R. 2146, the "Universal Default Prohibition Act of 2007" sponsored by Rep. Keith Ellison, to ban universal default. We have received numerous complaints that more and more banks are reviewing credit reports of existing customers and raising rates due to a decline in credit score or an alleged one or two late payments to any other creditor, even if the consumer's payments to the credit card issuer are timely and the account is in good standing. Major issuers have claimed in testimony that the practice is not used in their bank, but they have changed its name, for example to "credit report risk score re-pricing." While we do not disagree that banks should be able to generally risk-price their products for safety and soundness purposes, we do not believe that universal default is being used as a proportional response. Instead, it is used merely as a tool to increase revenue.

Require Real Disclosure of Minimum Payment Warnings: Rep. David Price and others have introduced H.R. 1510, which that would require every consumer's credit card billing statement to include a new disclosure. The Minimum Payment Warning is one of the few disclosures that rises above the clutter and will make a difference, and that's the reason banks vehemently oppose this proposal. The minimum payment warning would tell consumers how many actual years it would take to pay off their specific credit card, at their current balance and interest rate, if they only made the minimum requested payment and never used the card again. We were disappointed when the Senate rejected the similar Akaka amendment during floor consideration of the draconian bankruptcy bill, S. 256, that became law[35] in 2005 after being successfully and aggressively sought by the credit card industry. That law includes yet another virtually worthless generic minimum payment disclosure pre-approved by the industry (and still being worked on by the regulators) that will not work to reduce the credit card debts that cripple many American consumers.

Ban Late Fee Penalties When Payments Postmarked Before Due Date: The IRS considers payments postmarked by the due date to be timely. HR 1461, by Mark Udall and others, would implement a similar "postmarked by due date" rule for credit cards. The bill includes a variety of other provisions, including a ban on universal default and limits on marketing to youth.

Ban Other Unfair Practices and Strengthen Disclosures: Following a landmark hearing[36] of his Permanent Subcommittee on Investigations, Senator Carl Levin has introduced S. 1395, which prohibits a variety of tawdry interest calculation methods, caps penalty interest rates at 7% above the pre-penalty rate, prohibits collection of interest on fees, requires creditors to give cardholder the option not to exceed credit limit in a transaction, prohibits repeat over-the-limit fees, bans "pay to pay" fees and requires other practices to be adequately disclosed.

Give College Students And Other Young People Only The Credit They Deserve: Credit card companies issue credit to students without looking at credit reports (they don't have any) and

without regard to ability to repay. Other Americans must have a good credit report or a co-signer to obtain credit. College students merely apply. College students and other young people should be protected from credit card debt hassles by having to meet similar standards, as HR 1461 would provide. The proposed bill offers several ways for young consumers to qualify to obtain credit cards.

Ban Fees For Paying Bill: In response to complaints from consumers that banks are charging fees to pay bills by phone or computer, Rep. Ackerman has introduced HR 873 to ban fees imposed for timely payment of a bill by phone or electronic transfer.

Further Restrict Pre-Acquired Account Telemarketing: Many of the deceptive practices described in the state actions above involve banks sharing customer information with tawdry third-party telemarketers selling even tawdrier products characterized by over-priced travel clubs and mediocre health insurance plans. In our view, neither the provisions of Gramm-Leach-Bliley dealing with encrypted credit card numbers nor changes to The Telemarketing Sales Rule have adequately stopped banks from treating their customers unfairly due to the lure of massive commissions from their telemarketing partners.

Cap Interest Rates: Reinstate federal usury ceiling for credit cards to prohibit the use of unconscionable penalty interest rates. Prime plus ten per cent seems like a reasonable profit.

Ban Mandatory Pre-Dispute Arbitration: The Congress has enacted legislation protecting car dealers from unfair arbitration clauses in their contracts with car manufacturers. The Senate has in the past passed (and is now considering again) legislation similarly protecting farmers from arbitration in their contracts with powerful agri-business concerns. It is time to enact similar legislation to protect consumers. Rep. Gutierrez has introduced HR 1443, to ban mandatory pre-dispute arbitration in consumer contracts.

Ban The Use of Arbitration in Debt Collection Schemes: Arbitration agreements are not only being used in attempts to prevent consumers victimized by deceptive advertising and interest rate practices to have their day in court. Increasingly, according to a recent report by the National Consumer Law Center, major credit card companies, including First USA and MBNA, are partnering with arbitration firms to establish debt collection mills that force consumers into paying debts, including debts they may not even owe:

> Now, at least two giant credit-card issuers and one of the nation's largest firms arbitrating their consumer disputes have combined these practices in a disturbing new way: They're using binding, mandatory arbitration primarily as an offensive weapon, by fast-tracking disputes over credit-card debt into rapid arbitration. A number of consumers charge that the banks often do this with little notice, after long periods of dormancy for the alleged debt or over consumers' specific objections -- then force those who don't respond swiftly or adequately into default. The arbitrator often forces the consumer to also pay for the hefty arbitration costs and the card issuer's attorney, making the total tab for consumers several times the original amount owed and many times what it would have been in more traditional debt settlements. So it's a neat pathway to turbo-charged profits for both the card issuer and the arbitrator.[37]

We were disappointed that the Congress in 2005 enacted a one-sided bankruptcy bill, absent proof of abuse, and respectfully urge you to consider our proposals to rein in the unfair credit card company practices described above that have exacerbated the growth of credit card debt, which is the real problem we face, not abuse of the bankruptcy laws. In addition to the bankruptcy law's general manifest harshness and its intended elimination of a critical safety net during uncertain economic times, the bill's nominal credit card disclosures are deficient and unacceptable, as we pointed out above.

In addition to banning certain practices as above, in 2005, U.S. PIRG joined National Consumer Law Center and other leading groups in comments[38] to the Federal Reserve on ways to improve credit card disclosures. Those comments were part of the rulemaking that resulted in the recent issuance of proposed rules changes[39] by the Fed. The consumer group comments provide a window on the way that the industry exploits loopholes and inconsistencies in the act to hurt and exploit consumers. The TILA was supposed to be a remedial act, a law written to prevent unfair practices, and has often been correctly interpreted that way in the courts, yet the regulators have insisted on allowing the industry to carve out nooks and crannies that allow it avoid the spirit of the law. The proposals augment and update the disclosures in the important 1988 disclosure legislation that established what is known as the "Schumer" box, which requires credit card company solicitations to clearly and prominently disclose all fee and interest related "trigger terms."[40] We intend to follow additional comments in response to the proposed rule.

Additional key statutory changes recommended in those comments included the following recommendations which were not included in the proposed rule:

- A cap on all other charges, whether considered a finance charge or not, to an amount the card issuer can show is reasonably related to cost.
- No unilateral change-in-terms allowed.
- No retroactive interest rate increases allowed.
- No penalties allowed for behavior not directly linked to the specific card account at issue.
- No over limit fees allowed if issuer permits credit limit to be exceeded.
- No improvident extensions of credit –require real underwriting of the consumer's ability to pay.
- Meaningful penalties for violating any substantive or disclosure that provide real incentives to obey the rules.
- A private right of action to enforce section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive practices by businesses, including banks.

(6) STATE PREEMPTION ANOTHER PART OF THE PROBLEM

Although states had recently aggressively sought to enforce unfair and deceptive practices laws against credit card companies, the states have been limited in their enforcement by the growing use of preemption theory to restrict their regulation of the industry. In 1978, in Marquette,[41] the Supreme Court held that states could export nationally the interest rates of the bank's home state, prompting a concentration of the industry in a few bank-friendly states, including Delaware and South Dakota. In 1996, the court in Smiley[42] extended the Marquette holding by defining late fees as "interest," for the purpose of allowing a bank's home state late fees rules to similarly be exported nationally.

These onerous decisions applied to the regulation of interest. In 2002, a U.S. District Court used National Bank Act preemption theory, backed by the OCC, to overturn an important new California law requiring a monthly minimum payment warning, further restricting the states.[43] Then, of course, in 2004, the OCC imposed two onerous administrative rules restricting states from enactment or enforcement against national banks and their state-licensed operating subsidiaries[44] which has resulted in further court decisions upholding the rules.

These decisions and actions have aided and abetted the anti-consumer practices of this industry and deserve careful scrutiny by the committee. We remain disappointed that, at a minimum, the committee has not reined in the over-reaching OCC rules, although it did in 2004 condemn the OCC[45] when it passed a bipartisan budget resolution[46] on a vote of 34-28, stating that the OCC action "may represent an unprecedented expansion of Federal preemption authority" and "comes without congressional authorization, and without a corresponding increase in budget resources for the agency." The committee also pointed out that without a budget increase, the OCC cannot really expect its modest staff of forty consumer-complaint specialists to both continue their own work and also take over much of the work of an estimated 700 state consumer enforcers and examiners. "In the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions."

(7) CONCLUSION

We thank you for holding this important oversight hearing. We have attempted to describe a failed enforcement climate that has led to a pattern of sharp industry practices. Improved disclosure is an inadequate solution. The committee must ban unfair practices, it must conduct oversight into the lack of action by federal regulators and it must restore the second two enforcement arms against unfair practices: private enforcement and state attorney general enforcement. We hope that we have provided you with adequate information to support the need for action by the Congress to rein in the credit card industry's most unfair and abusive practices and would be happy to work with your staffs on proposed legislation.

ENDNOTES

[1] See an Office of the Comptroller of the Currency (OCC) regulatory interpretative letter endorsing debt cancellation and debts suspension products at http://www.occ.treas.gov/interp/jan01/int903.doc

[2] The consumer organizations testifying today, U.S. PIRG and the Center for Responsible Lending, and many others, including the Consumer Federation of America and Consumer Action, are all members of a broad new campaign to educate the public and the Congress about the need to eliminate one-sided binding mandatory arbitration (BMA) clauses in consumer contracts. See http://www.givemebackmyrights.org/

[3] It is the bank position that the Truth In Lending Act allows them to change fixed rates with as little as fifteen days notice and that a fixed rate is merely a rate that is not variable. A variable rate is defined as one tied to an index, such as the Wall Street Journal prime rate as disclosed on a certain date.

[4] Primarily a credit card bank, as opposed to a multi-faceted bank with a variety of products.

[5] Obtain the guidances and copies of the regulatory actions at the OCC credit card practices website available at http://www.occ.treas.gov/Consumer/creditcard.htm

[6] See OCC Consumer Assistance: Process Is Similar To That of Other Regulators But Could Be Improved by Enhanced Outreach, at page 23, U.S. Government Accountability Office, February 2006, available at http://www.gao.gov/new.items/d06293.pdf

[7] Capital One is regulated by the Federal Reserve Board, as a state bank.

[8] See testimony of Professor Art Wilmarth, 26 April 2007, before Financial Institutions and Consumer Credit Subcommittee, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htwilmarth042607.pdf

[9] 31 December 2002, FIRST USA TO HALT VENDORS' DECEPTIVE SOLICITATIONS, Press Release of New York Attorney General Eliot Spitzer, available at http://www.oag.state.ny.us/press/2002/dec/dec31a_02.html

[10] 27 Feb 2002, AGREEMENT CURBS TELEMARKETING APPEALS TO BANK CUSTOMERS, Press Release of New York Attorney General Eliot Spitzer, available at http://www.oag.state.ny.us/press/2002/feb/feb27b_02.html

[11] See, for example, a temporary injunction against Cross Country for available at http://www.ag.state.mn.us/consumer/PDF/CrossCountryBank.pdf

[12] See "State Sues Cross Country Bank over Harassing Debt Collection Practices," 3 April 2003, Minnsota Attorney General. In November, 2004 the state obtained a temporary injunction barring the bank's abusive practices. See http://www.ag.state.mn.us/consumer/PDF/CrossCountryBank.pdf

[13] 24 June 2004, Press release of Pennsylvania Attorney General's Office "AG Pappert takes action against bank and its collection company in alleged predatory lending/credit card scheme."

[14] 9 May 2005, See news release "ATTORNEY GENERAL DARRELL McGRAW SUES TO ENFORCE SUBPOENAS INVESTIGATING CAPITAL ONE BANK AND CAPITAL ONE SERVICES," available at http://www.wvago.gov/

[15] According to the Federal Reserve Board, "8 November 2006 Order Approving Merger of Bank Holding Companies (Capital One and North Fork): The Board notes that in February 2006, Capital One and the State of Minnesota entered into a Consent Judgment, which by its terms constituted a full and final resolution of all claims brought by the state and was not deemed an admission of liability by Capital One. According to the terms of the Consent Judgment, Capital One agreed not to distribute certain advertisements in Minnesota for a period of 18 months after the date of the Consent Judgment and to pay a total of $749,999, to be divided equally among Minnesota based chapters of the Legal Aid Society, the Minnesota Association of Community Organizations for Reform Now, and the State of Minnesota. Available at http://132.200.33.130/boarddocs/Press/orders/2006/20061108/attachment.pdf

[16] See "Providian to Refund $300 Million to Consumers Over Alleged Abusive Credit Card Practices," 28 June 2000 available at California Attorney General page http://ag.ca.gov/newsalerts/release.php?id=689&year=2000&month=6

[17] June 28, 2000, Statement of Comptroller of the Currency John D. Hawke, Jr.

[18] Fact Sheet Regarding Settlement Between the OCC and Direct Merchants Bank, 3 May 2001

[19] Again, these cases and guidnaces are listed here http://www.occ.treas.gov/Consumer/creditcard.htm

[20] Industry witnesses may trumpet a recent proposed settlement for $336 million against major banks and the card associations for actions involving credit card foreign transaction fees. We note that that at the core of this case were Sherman Act antitrust violations and the threat of treble damages, not consumer law violations.

[21] See Rossman v. Fleet Bank (RI) Nat'l Ass'n, 280 F.3d 384, 390-91 (3d Cir. 2002) available at http://laws.lp.findlaw.com/3rd/011094.html

[22] See Rossman v. Fleet Bank (RI) Nat'l Ass'n, 280 F.3d 384, 390-91 (3d Cir. 2002) available at http://laws.lp.findlaw.com/3rd/011094.html

[23] Eliminating Barriers to Credit and the Challenges of Credit Card Use for Latino Consumers, by Beatriz Ibarra, testimony presented to the U.S. Senate Banking Committee, 1 February 2007, available at http://www.nclr.org/content/publications/detail/44284/

[24] See "The Burden of Borrowing," the State PIRGs' Higher Education Project, March 2002, available at http://www.pirg.org/highered/highered.asp?id2=7972

[25] See "Graduating Into Debt: Credit Card Marketing on Maryland College Campuses," February 19, 2004, Maryland Consumer Rights Coalition and Maryland Public Interest Research Group, available at http://marypirg.org/MD.asp?id2=12264&id3=MD&

[26] "The Roadmap To Avoid Credit Hazards" is downloadable at http://www.truthaboutcredit.org/roadmap.pdf. Numerous other materials and reports are available at http://www.truthaboutcredit.org .

[27] Available at http://www.consumer-action.org

[28] See the state PIRG credit card education website http://www.truthaboutcredit.org

[29] Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions, Federal Reserve Board of Governors, June 2006, available at http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2006/ccprofit.pdf

[30] The March 2007 data estimate $888 billion. This figure must be deflated to account for non-credit card debt and for a share of debt that is paid off on a timely, monthly basis, so we use $800 billion. See G19 Consumer Credit release of 7 May 2007 available at http://www.federalreserve.gov/releases/g19/current/default.htm

[31] The banks frequently cite a Federal Reserve analysis of University of Michigan Survey of Consumer Finances polling data to allege that only 45% of consumers carry a balance. Consumer group contacts with industry sources

indicate that these numbers are low. If true, of course, average balances would be even higher. Consumer groups use a conservative figure of 55% carrying balances, with some sources putting the nmber as high as high as 60% or more. For a discussion of our analysis of credit card debt, see the state PIRG report "Deflate Your Rate," March 2002, available at http://www.truthaboutcredit.org

[32] OCC Advisory Letter AL 2004-4, April 28, 2004, available at http://www.occ.treas.gov/ftp/advisory/2004-4.txt

[33] "The Profitability of Credit Card Operations of Depository Institutions: An Annual Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988," June 2006, available at http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2006/ccprofit.pdf We call particular attention to the testimony of victim Wesley Wannamaker.

[34] According to Mail Monitor, the direct mail tracking service from Synovate.

[35] Public Law No. 109-8.

[36] "Credit Card Practices: Fees, Interest Rates, and Grace Periods, 7 March 2007, Hearing of the Senate Permanent Subcommittee on Investigations, available at http://hsgac.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=421

[37] See 17 February 2005, "New Trap Door for Consumers: Card Issuers Use Rubber-Stamp Arbitration to Rush Debts Into Default Judgments," National Consumer Law Center, available at http://www.consumerlaw.org/issues/model/content/ArbitrationNAF.pdf

[38] See See Comments of National Consumer Law Center, U.S. PIRG, Consumer Federation of America et al "Regarding Advance Notice of Proposed Rulemaking: Review of the Open-End (Revolving) Credit Rules of Regulation Z," Federal Reserve System, 12 CFR Part 226, Docket No. R-1217 available at http://www.consumerlaw.org/initiatives/test_and_comm/content/open_end_final.pdf

[39] See Federal Reserve press release of 23 May 2007 with appendices, available at http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm

[40] The Fair Credit and Charge Card Act of 1988's disclosures were championed by Representative Chuck Schumer as a member of this committee; he is now a Senator.

[41] In 1978, the Supreme Court in Marquette vs. First Omaha Service Corp invalidated state usury laws as they apply to national banks. Marquette held that under Section 85 of the National Bank Act (NBA) of 1863 national banks could export to any of their customers, no matter where they lived, the highest interest rate allowed in the bank's home state, now usually Delaware, Virginia, Nevada or South Dakota. See Marquette Nat. Bank. V. First of Omaha Services, 439 US 299 (1978).

[42] In Smiley, the Supreme Court extended Marquette to allow exportation of a home state's fees. The court paid deference to a new OCC rule that added a wide range of fees to the definition of interest under Section 85 of the National Bank Act, including late fees, over limit fees, annual fees, and cash advance fees. See Smiley v. Citibank (South Dakota). 517 US 735 (1996)

[43] Since the federal Truth In Lending was non-preemptive with respect to certain account statement disclosures, California enacted legislation (Civil Code Section 1748.13) requiring that monthly credit card statements disclose information about how long it would take to pay off a card if you only made the minimum requested monthly payment. Federal law did not then require this, although a similar, weaker provision is included in the Bankruptcy law recently signed (Public Law 109-8). The law was overturned on summary judgment in American Bankers Association v. Lockyer, 239 F. Supp. 2d 1000, 1009 (E.D. Cal. 2002).

[44] See the PIRG OCCWatch website for detailed information on the OCC's anti-consumer actions, including links to its rules, http://www.pirg.org/occwatch Also see "Preemption Of State Consumer Laws: Federal Interference Is A Market Failure," by U.S. PIRG's Edmund Mierzwinski, which appeared in the Spring 2004 (Vol. 6, No. 1, pgs. 6-12) issue of the Government, Law and Policy Journal of the New York State Bar Association. The article includes a major section on the OCC rules, available at http://www.pirg.org/consumer/pdfs/mierzwinskiarticlefinalnysba.pdf

[45] News story on committee vote available here: http://www.housingchoice.org/news%20stories/2004/02272004.htm

[46] See Comm. On Fin. Serv., 108th Cong., Views And Estimates Of The Committee On Financial Services On Matters To Be Set Forth In The Concurrent Resolution On The Budget For Fiscal Year 2005, At 15–16 (Comm. Print 2004).

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Statement of

Frederic S. Mishkin

Member

Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

U.S. House of Representatives

June 7, 2007

Madam Chair Maloney, Ranking Member Gillmor, members of the Subcommittee, I appreciate the opportunity to discuss the Federal Reserve Board's May 23, 2007, proposal to revise the credit card disclosures required by current Truth in Lending Act (TILA) regulations. The Board's proposed revisions to Regulation Z, which implements TILA, also apply to other revolving credit accounts not secured by a residence. However, I will focus my remarks on credit cards, the subject of this hearing and by far the most common form of open-end accounts that are not home-secured.

Many more households have obtained credit cards since the Board last reviewed TILA regulations comprehensively in 1981. In the early 1980s, less than half of American families had at least one general purpose credit card (43 percent in 1983), and now close to three quarters have at least one (71 percent in 2004). The increase was sharpest among lower-income families. From 1983 to 2004, the share of families in the lowest income quintile that hold a credit card jumped from 11 percent to 37 percent. Not only are more consumers holding credit cards, consumers are using their cards more. Total charges on credit cards increased by about four times from 1991 to 2004 alone.[1]

Growth in credit card use is explained in part by consumers switching from other forms of credit such as installment loans. Growth has also been enhanced by changes in consumer preferences related to the convenience and security of using card forms of payment rather than cash. Another substantial contributor has been the development of credit scoring and risk-based pricing, which has increased use of credit cards by consumers who traditionally lacked access because of poor or limited credit histories.

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[1] Board of Governors of the Federal Reserve System (2006), Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and their Effects on Consumer Debt and Insolvency (Washington: Board of Governors of the Federal Reserve System), tables 3 and 6.

As credit cards have become more commonplace, they also have become more complicated. Even a relatively simple credit card account is more complex than the fixed-payment installment loan it may have replaced. Moreover, most credit cards can no longer be described as relatively simple. Once, a card may have allowed the user to make purchases or obtain cash advances and applied a single annual percentage rate, or APR, to each feature. Fees were limited to a fee for cash advances, an annual fee on the account, and perhaps a fee if the consumer paid late. Today, a card may also offer balance transfers and treat different classes of purchases and cash advances as different features, each with its own APR. These APRs adjust much more frequently to respond to changes in the market or to changes in a borrower's credit risk profile. The typical card no longer has an annual fee, but it has many other fees tied to a variety of features, or to requirements of the credit agreement, or to a growing number of optional services.

All of these developments have joined to produce the seeming paradox that credit cards are both widely used and widely criticized. The Board is keenly aware of concerns over the fairness and transparency of card marketing and account terms. There is, for example, a concern that issuers advertise low introductory rates while downplaying that these rates can increase sharply. Observers worry that the varied reasons that rates can increase, sometimes by a factor of two or three, are not made clear when the consumer applies for the card, starts to use it, or builds up a substantial balance. Further, there are concerns that issuers' methods of calculating interest, such as the ways they choose to allocate customers' payments to different balances, are confusing or not clearly disclosed. More broadly, the presence in the market of terms seemingly unfavorable to consumers appears to some to indicate that the market is not fully competitive.

The Board's Goals and Process

The goals of our proposed revisions to credit card disclosures are to aid consumer decisionmaking and improve competition. More effective disclosures make information about terms and pricing easier for consumers to obtain and understand. When that happens, individual consumers are less likely to fall into "traps for the unwary" and are more able to choose products that offer the best combination of features and pricing to meet their personal financial needs. Better dissemination of information about credit card terms and pricing also enhances competition among credit card issuers, which, in turn, helps generate products that consumers want.

To achieve these goals, the Board's proposal seeks to ensure that consumers receive key information about the costs of credit card transactions in ways they can understand, in formats they can use, and at times when it is most helpful. To help us craft a proposal to meet these specific objectives, we considered the traditional sources: public input we received in over 250 comment letters, available sources of data and information, and our own long experience implementing TILA. We also considered what consumers, themselves, had to say. As part of extensive consumer testing, we interviewed consumers individually about their use and understanding of different disclosures. Consumers told us what information they find useful when making credit decisions and what information they ignore. We learned which words and formats for presenting information promote understanding and which do not. These lessons are reflected in a myriad of preliminary judgments we have made about appropriate disclosure content, format, and timing.

The judgments required were not always clear-cut. Frankly, it is sometimes difficult to determine which transaction terms are most important because consumers use credit cards in

many different ways. It is also difficult to determine how much information about those terms is enough; what information should be highlighted, and what should be disclosed less prominently; what information should be disclosed early on in the transaction, and what can be reserved for later. The Board also must balance a rule's specificity, which makes disclosures more consistent and reduces the risk of non-compliance, with its flexibility, which reduces operational burdens and ensures that disclosures can be adapted to changes in credit products and practices. In addition, the Board tried to ensure that creditor compliance and operational burdens are justified by the expected benefits to consumers and competition, and to reduce existing burdens if they are not warranted.

Developing effective credit card disclosures is particularly challenging because of the complicated and dynamic nature of the product. First, explaining the effective cost of credit before the consumer uses the card is difficult because key elements affecting the cost, such as whether the consumer will pay off balances regularly or carry balances that incur finance charges, are unknown. So TILA requires disclosures that provide consumers several terms that, together, determine the effective cost of credit: the periodic rate and nominal APR, other charges such as fixed and minimum fees, the grace period, and the balance calculation method. Clearly and simply explaining what these terms mean and how collectively they determine the cost of credit is difficult. Second, effectively disclosing credit card pricing becomes more difficult as credit card pricing grows more complex with the spread of risk-based pricing and penalty pricing and the "unbundling" of the price of a credit card into many different types of rates and fees. Clearly explaining costs contingent on future events that might seem remote when disclosures are made and promoting awareness of the total cost--not just component costs--pose additional

challenges. Third, credit card pricing and features will continue to change, which means that we must try to craft disclosure requirements that work today and as products change.

The Board's Proposal

Taking all of this into account, the Board has developed a comprehensive proposal to revise Regulation Z that includes the following specific elements:

- Advertisements of introductory rates would more clearly disclose the eventual higher rates and how soon they would be imposed;
- Advertisements of "fixed" rates would be restricted to rates that are truly not subject to change, either for a clearly disclosed period or for the life of the plan;
- The "Schumer box" required with credit card solicitations and applications would be updated to more effectively present information about rates and fees. As can be seen in the attached model form, the most critical rate and fee information would be presented in the box; rates and fees would be separated into two sections; and graphic techniques such as minimum font size, judicious bolding, and vertical alignment of key numbers would make it easier to read and use;
- Summary tables similar to the Schumer box would accompany the lengthy, complex credit agreements that consumers receive both when they first open an account and would also be provided, later, when account terms are amended. A model of this new disclosure is attached;
- The penalty rate and penalty fees would be highlighted in the Schumer box and the account-opening summary table; and a reminder of late payment penalties would appear on every periodic statement;
- A consumer would be sent notice forty-five days before a penalty rate was imposed or the rate was increased for other reasons;
- The cumulative cost of fees would be highlighted every month, as can be seen in the attached model of a periodic statement. Fees charged in the last cycle would be grouped

together on the statement in a prominent location and totaled for the cycle and year-to-date;

- The periodic statement's "effective APR," another way of disclosing the total cost of credit, is the subject of two alternative proposals. Under one, the effective APR could be revised to make it simpler for creditors to compute and potentially easier for consumers to understand. Under the other, if continued consumer testing, the public comments and the Board's analysis indicate that the effective APR does not have a meaningful benefit, then it could be eliminated, as the statute authorizes;
- Consumers would be warned on the periodic statement about the higher cost of making only minimum payments, and creditors would be provided incentives to give consumers a more precise estimate of the time to repay the balance and to place that estimate on the periodic statement rather than make it available by telephone; and
- Creditors would receive clearer guidance as to what charges must be disclosed, when, and how, along with increased flexibility to disclose charges at times and by methods more convenient to the creditor and consumer alike.

We are committed to providing the public a meaningful opportunity to evaluate and comment on these and other elements of the proposal, most of which are detailed in Appendix I. The Board has posted to its web site a lengthy report of its consumer testing, which forms the basis for major elements of the proposal, and has explained the reasons for the proposal in some detail in over 300 pages of "supplementary information." The public has four months to submit comment letters, which the Board expects will contain many useful responses and suggestions.

I want to say more about two elements of the proposal that we expect will elicit vigorous comment. The first is the proposed new notification requirement when rates are raised. With some exceptions, the current regulation requires that notice be mailed fifteen days before a rate increase takes effect. The Board is concerned that this notice can leave consumers too little time

to react and possibly to shop for alternative sources of credit or pay off the existing credit card balance under existing terms. Further, one of the current exceptions to the fifteen-day notice requirement is for rate increases that are penalties (for example, for exceeding the credit limit). The Board believes that consumers will not necessarily anticipate penalty-based rate increases when the penalty was disclosed in credit agreements they received months, or even years, earlier. Thus, the Board has proposed to lengthen the notice period for a rate increase to forty-five days and require advance notification of penalty-based rate increases as well. In practice, consumers would have the benefit of more than a month to pursue their options, and creditors would forego collecting some interest revenue. The Board wants to receive comments addressing whether the costs are justified by the benefits.

The two alternative proposals concerning the effective APR on the periodic statement also are expected to elicit vigorous comment. The effective APR reflects the cost of interest and certain other finance charges imposed during the statement period. As an example, a cash advance carries an effective APR that reflects both interest assessed on the balance in the billing period and any fee charged by the creditor for the cash advance. The effective APR can be quite high, often much higher than the nominal APR, in part because it amortizes the cost of credit, including fees, over one month. Although consumer groups argue that the resulting "sticker shock" helps consumers make better credit shopping and account management decisions, creditors argue that it confuses consumers and misleads them to think the cost of credit is higher than it is.

Consumer testing conducted for the Board suggests that many consumers have a limited understanding, if any, of the effective APR, but it also suggests that clearer presentation of the disclosure can improve understanding. Thus, the proposal seeks to present the effective APR

more clearly to consumers with more straightforward terminology and better formatting that promotes understanding. In addition, the proposal seeks to improve consumer understanding and reduce creditor uncertainty by specifying more clearly than the present regulation which fees are to be included in the effective APR. However, because of inherent limitations of the calculation--such as the need to assume the repayment period--and continued concern that adequate consumer understanding may be difficult to achieve, the Board is also seeking comment on an alternative proposal to eliminate the disclosure. When evaluating these two alternatives, and any others the public comments might suggest, the Board will consider the comments as well as the results of additional consumer testing.

Conclusion

Madam Chair, in closing, let me emphasize the Federal Reserve's commitment to ensuring that consumers get key information about credit card terms in ways they can understand, in formats they can use, and at times when it is most helpful. We appreciate efforts in the Congress and among consumer groups and the credit card industry to ensure that disclosure practices are in line with the needs of consumers. As my testimony this morning indicates, more complex pricing and continuous change in the marketplace make the task of writing rules for effective disclosure challenging. Nevertheless, the combination of extensive review, substantial public input, and systematic consumer testing has enabled us to propose changes that we believe will further the original goals of the Truth in Lending Act to promote economic stability and competition through the informed use of credit. I look forward to our continuing efforts in this regard, and I am happy to address any questions you might have.

Appendix to Statement of
Frederic S. Mishkin
Member
Board of Governors of the Federal Reserve System
June 7, 2007

Summary of Proposed Changes to the Federal Reserve Board's Regulation Z

The following summary is organized according to the major disclosures required under Regulation Z. For more information, see the Federal Register notice the Board approved on May 23, 2007.

Advertisements

Regulation Z requires that advertisements that contain certain information about the cost of a loan disclose additional information to give the consumer a fuller picture of the cost. The regulation also requires that terms advertised actually be available.

Advertising discounted rates. Under a proposal that would implement a Bankruptcy Act requirement, creditors that advertise a discounted initial annual percentage rate (APR) in connection with an application or solicitation would have to place the term "introductory" or "intro" near each mention of that rate. Close to the first mention, creditors would disclose prominently the introductory rate's duration and the higher rate that would apply afterwards. Creditors would also disclose, in the "Schumer box," the conditions under which consumers could lose the discount prematurely (e.g., if the consumer pays late).

Advertising "fixed" rates. Consumer testing indicated that many consumers believe that a rate advertised as "fixed" will not change and do not understand that "fixed" may only mean that the rate does not vary based on changes in an index or formula. Under the proposal, an advertisement may refer to a rate as "fixed" only if the advertisement specifies a period during which the rate cannot increase for any reason (and the agreement does not give the creditor the right to increase it during that period), or if the rate will not increase while the plan is open.

Advertising minimum payments. Consumers commonly are offered the option to finance the purchase of goods or services (such as appliances or furniture) by establishing an open-end credit plan, which may or may not be accessed by a credit card. These offers often advertise monthly minimum payments associated with the purchase. Under the proposal, advertisements stating a minimum monthly payment for an open-end credit plan to finance the purchase of goods or services must state, as prominently as the minimum payment, the time it would take to pay the balance and the total amount the consumer would pay if the consumer made only minimum payments.

Credit Card Applications and Solicitations; the "Schumer box"

Under Regulation Z, credit card issuers are required to provide information about key costs and terms with their applications and solicitations in the form of a table often referred to as the "Schumer box." The table is intended to help consumers focus on the most important terms when comparing offers and deciding whether to apply for a credit card account. A model of the proposed new Schumer box is attached.

Format. Consumer testing showed that the basic format of the Schumer box, the vertical presentation of information in a tabular format with headings on the left-hand side, is quite effective. Testing also suggested, however, that reorganizing the information, adding certain new information, and removing other information would make the box more effective in disclosing today's more complex pricing of credit cards. The proposed new Schumer box reflects these lessons. For example, consistent with testing findings, it separates the box into two parts, "interest rates and interest charges" and "fees." In the first part, it presents each major type of APR, such as a cash advance APR and a penalty APR, in a separate row instead of grouping them under the single heading "other APRs." The fee section divides fees into major categories, such as transaction fees and penalty fees; today these fees may appear below the box, where testing confirms consumers do not readily notice them. Cross-references between the interest and fees sections were found to help ensure that consumers understand that both types of costs can apply to the same transaction. The proposed new Schumer box also incorporates graphic techniques such as a minimum font size of ten points, judicious bolding of text, and vertical alignment of key numbers. Other changes to the content and format of the Schumer box are discussed below.

Rates based on creditworthiness. A creditor may disclose at solicitation a range of APRs or several discrete APRs because it will determine a particular applicant's rate based on an evaluation of creditworthiness. The proposal would require the creditor to disclose in simple terms, tested with consumers, that the rate the applicant receives would be based on the applicant's creditworthiness.

Adjustable rates. Currently, if an application or solicitation offers a variable APR, the creditor must disclose inside the Schumer box the index or formula and the margin used to determine the rate. Additional details, such as how often the rate may change, must be disclosed outside the box. Consumer testing indicated that few consumers use details such as the index and margin when shopping for a card and, moreover, that consumers may be distracted or confused by such details. Under the proposal, information about variable APRs would be reduced to a single phrase indicating the APR varies "with the market," along with a reference to the type of index, such as "Prime." Details about the rate's determination would continue to be disclosed to consumers at account opening.

Fees. Participants in consumer testing often did not notice fees if they were disclosed outside the Schumer box, as is common today. The proposal requires card issuers to disclose inside the box the most common penalty fees, namely, fees for paying late, exceeding a credit limit, or making a payment that is returned. The fee disclosure must also refer the consumer to the penalty rate if, for example, paying late could also trigger the penalty rate. The most

common transaction fees, such as cash advance fees and balance transfer fees, also would be disclosed inside the box.

Penalty pricing. The proposal would make several improvements to the Schumer box to increase consumers' understanding of default, or penalty, pricing. Currently, credit card issuers must disclose inside the box the APR that will apply in the event of the consumer's default. However, they must disclose the actions that may trigger the penalty APR outside the box, where, according to consumer testing, this information often goes unnoticed. Under the proposal, therefore, card issuers would be required to include inside the box the specific triggers of a penalty APR--such as paying late on the account. Creditors would also disclose the rate that will apply, the balances to which the penalty rate will apply, and the circumstances under which the penalty rate will expire or, if true, the fact that the penalty rate could apply indefinitely. The proposal would require card issuers to use the term "penalty APR" because testing demonstrated that some consumers misinterpret the term "default rate." Creditors can use the term "default" to refer to one late payment, but consumers sometimes understand "default" to imply a more serious breach, or to mean something else entirely.

Payment allocation/loss of grace period. The proposal would add a new disclosure to the Schumer box about the effect on credit costs of creditors' payment allocation methods. It is common for a creditor to allocate payments first to low-rate balances such as promotional balance transfers. Consumers who make purchases at a higher rate will not be able to take advantage of any "grace period" on the higher-rate purchases until they pay off the entire lower-rate balance transfer, which they may not have intended to do until the promotional rate expired. Consumer testing indicated that consumers are often confused about this aspect of balance transfer offers; testing also indicated that a disclosure that is short and simple while accurate and complete is challenging to achieve. The proposal seeks to balance these objectives in a new disclosure that alerts consumers that they will pay interest on their purchases until they pay the transferred balance in full.

Subprime accounts. Subprime credit cards, cards offered to consumers with low credit scores or with credit problems, sometimes have substantial fees associated with opening the account. Typically, these fees are billed to consumers on the first periodic statement, and can substantially reduce the amount of credit available to the consumer. For example, the initial fees on an account with a credit limit of $250 may reduce the available credit to less than $100. Consumers have complained that they were not aware that so little credit would be available to them. To address this concern, the proposal would require a card issuer offering a low credit limit and high initial fees or security deposits (25 percent or more of the minimum credit limit) to include in the Schumer box the amount of available credit the consumer would have after paying the fees or security deposit, assuming the consumer received the minimum credit limit.

Account-Opening Disclosures

Regulation Z requires creditors to disclose rates, charges, and related terms such as grace period and balance calculation method before the first transaction on the account. Consumers' rights and responsibilities in the case of unauthorized use or billing disputes must also be explained. Currently, Regulation Z imposes few format requirements on these disclosures and creditors typically integrate them with the cardholder agreement, which is usually dense and long.

Account-opening summary table. The proposal requires creditors to include a table summarizing the most important terms in an easy-to-follow format, substantially similar to the Schumer box the consumer typically would have seen with the application. An example of this new table is attached.

Fees. Under the current rules, a creditor must disclose any fee that is a "finance charge" or "other charge" in the written account-opening disclosures and generally has no obligation to disclose it again, unless the charge is increased. New fees added to the plan after account opening must be disclosed before they take effect and later if they increase. (Of course, after a fee is charged, it must appear on the periodic statement; disclosure at that stage is discussed later.) Creditors have sometimes had difficulty determining whether a particular fee is properly classified as a "finance charge" or "other charge," or as neither of these. Although the regulation and commentary give specific guidance, sometimes new services develop before the guidance can be updated. When that happens, creditors can find it difficult to determine if the fee for the service must be disclosed in writing at account opening (or before the fee takes effect, if a service is added later). This uncertainty can pose legal risks for creditors that act in good faith to comply with the law, and it can lead to inconsistent disclosure to consumers.

Moreover, it is not clear that consumers benefit from requiring creditors to disclose every potential fee in writing and at account opening. It may be months, and possibly years, until the consumer requests the service for which the fee is imposed. Furthermore, the consumer may request the service by telephone for speed and convenience, and not expect to have to wait for a written disclosure before the transaction can be completed.

The proposal seeks to address these potential limitations of the present rule while taking into account the Truth in Lending Act's (TILA) requirement to disclose plan-related charges before they are imposed. Accordingly, under the proposal, the rules would be revised to (1) specify precisely the charges that creditors must disclose in writing at account opening (interest, minimum charges, transaction fees, annual fees, and penalty fees such as for paying late), which would be listed in the summary table referred to above; and (2) permit creditors to disclose other charges, typically fees for optional services that may be used infrequently, orally or in writing before the consumer agrees to or becomes obligated to pay the charge. To prevent abuse of this flexibility, the proposal requires that an oral disclosure be clear and conspicuous, and that it be given when the consumer would likely notice it.

Periodic Statements

Once an account has been opened, creditors are required to provide periodic statements reflecting the account activity for each billing cycle, typically monthly. The statement must identify each transaction on the account, such as a purchase or cash advance. It must also identify each "finance charge" (using that term) and other charges imposed as part of the plan during the cycle. And it must identify the periodic rate(s) and corresponding annual percentage rate(s), also known as the nominal APR, that applied during the last cycle. If finance charges were imposed in the form of fees (e.g., a cash advance fee), as well as (or instead of) monthly interest, then the statement must disclose an effective APR reflecting the *total* finance charge, with limited exceptions. Under amendments to TILA made by the Bankruptcy Act that are implemented in this proposal, creditors must also disclose information about the cost of paying late or making only the minimum payment due. A model of the periodic statement that reflects the revisions discussed below is attached.

Transactions. As the regulation currently permits, transactions are often presented in chronological order and not by transaction type. Participants in consumer testing found it easier to read and use statements where similar types of transactions are grouped together. Accordingly, the proposal requires creditors to group similar transactions together by type, such as purchases, cash advances, and balance transfers.

Fee and interest charges. The proposal contains a number of revisions to the periodic statement to improve consumers' awareness and understanding of charges they have incurred in the form of fees or interest. Consumer testing indicated that consumers have difficulty understanding the term "finance charge." They are more likely to conceive of their charges as "interest," the charge that results from applying a rate to a balance, and "fees," such as a cash advance fee or a late payment fee. Consumer testing also indicated that many consumers more easily compute the number and amount of fees when the fees are itemized and grouped together. Participants noticed fees and interest charges more readily when they were located near the transactions. Also, many participants more quickly and accurately determined the total charges for the billing cycle when a total fee amount for the cycle was disclosed, as well as the total interest.

These findings led the Board to propose four changes to fee disclosures on the periodic statement. First, creditors would no longer have to label charges as "finance charges;" they would instead classify charges as "fees" or "interest." Second, creditors would be required to group all charges together in a discrete place on the statement under the headings "fees" and "interest charges." Third, these charges would appear near the transaction items. Fourth, creditors would disclose the total fees and total interest imposed for the cycle, and the totals for the year to-date.

The effective APR. The effective APR disclosed on periodic statements reflects the cost of interest and certain other finance charges imposed during the statement period. For example, for a cash advance, the effective APR reflects both interest assessed on the balance in the statement period and any fee assessed for the advance. The effective APR can be quite high, often much higher than the nominal APR, in part because it amortizes the cost of credit,

including fees, over one month. Although consumer groups argue that the resulting "sticker shock" helps consumers make better credit shopping and account management decisions, creditors argue that it confuses consumers and misleads them to think the cost of credit is higher than it is.

Consumer testing suggests that many consumers have a limited understanding, if any, of the effective APR, but it also suggests that clearer presentation of the disclosure can improve understanding. Thus, the proposal seeks to present the effective APR more clearly to consumers, giving it an intuitive label of "fee inclusive APR" and placing it next to other, related information such as the interest and fees it includes. In addition, the proposal seeks to improve consumer understanding and reduce creditor uncertainty by specifying more clearly than the present regulation which fees are to be included in the effective APR. However, because of inherent limitations of the disclosure (such as the need to assume the repayment period) and continued concern that an adequate level of consumer understanding may be difficult to achieve, the Board is also seeking comment on an alternative proposal to eliminate the disclosure. When evaluating these alternatives and any others the public comments suggest, the Board will consider the public comments as well as additional consumer testing the Board plans to conduct.

Late payments. The Bankruptcy Act requires creditors to disclose the payment due date (or if different, the date after which a late-payment fee may be imposed) along with the amount of the late-payment fee. The proposal implements this requirement and adds a requirement to disclose the penalty APR that could be triggered by a late payment. Creditors would be required to disclose the penalty fee and rate close to the due date. If the creditor uses an early cut-off time on the payment due date, the time would also have to be disclosed near the date.

Minimum payments. The proposal implements a requirement of the Bankruptcy Act that card issuers warn their customers on the periodic statement about the higher cost of making only minimum payments, give a hypothetical example of the time to repay a balance with minimum payments, and refer the customer to a toll-free telephone number for an estimate of the time to repay the current balance if paying only the minimum.[1] In testing conducted by the Board and in separate testing conducted by the U.S. Government Accountability Office (GAO), participants who typically carry credit card balances found an estimated repayment period based on terms that apply to their own account more useful than a hypothetical example. Accordingly, the proposal gives card issuers incentives to provide a more precise estimate of the time to repay and to place this estimate on the periodic statement. The incentives include exemptions from the requirements to maintain a toll-free telephone number and disclose the warning and hypothetical example.

Changes in Consumer's Interest Rate and Other Account Terms

Regulation Z requires creditors to provide advance written notice of some changes to the terms of an open-end plan. When notices are required, they must be sent fifteen days before the

[1] Card issuers must establish and maintain their own toll-free telephone numbers to provide the repayment estimates, except that depository institutions having assets of $250 million or less may rely for two years on a number the Board is required to establish and maintain for them, and non-depository creditors may rely on a number the FTC is required to establish and maintain for them.

effective date of the change. Creditors need not notify consumers before they increase a rate for default or delinquency, or as a penalty for other conduct if the credit agreement specifically provides for an increase.

Timing. Allowing creditors to mail a notice fifteen days before increasing the cost of credit can leave consumers too little time to receive the notice, shop for alternative credit, and possibly pay off the existing credit card account. Accordingly, the Board is proposing to require sending a notice at least forty-five days before the effective date of the change, which would give consumers over a month to pursue their options.

Penalty rates. Credit agreements sometimes define defaults that trigger rate increases quite broadly, and often provide that the increased rate will apply to all existing balances, including balances with low promotional rates. Months, or years, after receiving the credit agreement, a consumer may no longer remember that certain behaviors will trigger a rate increase and, therefore, may be surprised to learn, after the fact, that the rate has increased. Thus, the proposal would require a creditor to send a notice forty-five days before increasing the consumer's rate for default or delinquency or as a penalty for other conduct, to give the consumer time to shop for alternative credit sources and possibly pay off the account. The proposal does not limit actions creditors may take to mitigate risk, such as lowering the credit limit or suspending credit privileges.

Format. Change-in-terms disclosures, like account-opening disclosures, are commonly interspersed with other disclosures and written in small print and dense prose. Consumer testing indicates that many consumers set the documents containing these disclosures aside without reading them. Under the proposal, creditors must highlight critical changes in a summary table. Creditors that enclose their notices with periodic statements must place this table on the periodic statement above the transactions list, where consumer testing suggests consumers are most likely to notice it.

Checks that Access a Credit Card Account

Many credit card issuers provide accountholders with checks that can be used to obtain cash, pay the outstanding balance on another account, or purchase goods and services directly from merchants. The solicitation letter accompanying the checks may emphasize a low introductory APR for these checks. The proposed revisions would require creditors to disclose other rates and fees that will apply if the checks are used, rather than simply suggest the consumer review the disclosures provided at account opening. To ensure the disclosures are conspicuous, creditors would be required to place the rates and fees in a table on the same page as the checks.

Right to Dispute Billing Errors

The Board also has proposed several revisions to substantive and procedural protections TILA provides consumers. Four proposed revisions, in particular, would clarify Regulation Z in ways that strengthen consumers' rights to dispute billing errors on credit cards and other forms of revolving credit. First, if a creditor determined that no error occurred, the proposal would make clear that the creditor may not impose finance charges or other charges until the grace period (if

any) in the credit agreement has elapsed. Second, if a creditor credited a borrower's account for a disputed transaction, the proposal would make clear that the creditor may not reverse the credit after two billing cycles or ninety days, whichever period is shorter; this clarification is meant to ensure finality. Third, the proposal would make clear that the right to dispute billing errors covers check transactions that access open-end accounts. Fourth, the proposal would make clear that the right to dispute errors applies to purchases of goods or services made using a third-party payment intermediary, such as a person-to-person Internet payment service.

TESTIMONY OF RICHARD H. NEIMAN

Superintendent of Banks

New York State Banking Department

On behalf of the Conference of State Bank Supervisors

House Financial Services Subcommittee on Financial Institutions and Consumer Credit

June 7, 2007

Introduction

Good morning Madam Chair, Ranking Member Gillmor, and distinguished members of the Subcommittee. I am Richard Neiman, Superintendent of the New York State Banking Department. I am pleased to be here today to testify on behalf of the Conference of State Bank Supervisors (CSBS) on the need to improve disclosures and protections for users of bank-issued credit cards. I am particularly pleased because this is where my introduction to financial institutions really began. As a congressional intern, I worked my way through college for the then-House Banking Committee under Chairman Wright Patman. No one could have predicted that I would return to that same Committee, 30 years later, only now as Superintendent, to address this important issue.

Background on CSBS

CSBS is the professional association of state officials responsible for chartering, supervising, and regulating the nation's 6,206 state-chartered commercial and savings banks, and 400 state-licensed foreign banking offices nationwide. CSBS represents the bank regulators of the 50 states, the District of Columbia, Guam, Puerto Rico and the Virgin Islands. For more than a century, CSBS has given state regulators a national forum to coordinate, communicate, advocate and educate on behalf of state financial regulation.

Background on New York State Banking Department

The New York State Banking Department is the nation's oldest bank regulatory agency, responsible for the licensing, regulation and supervision of domestic state-chartered banks; foreign agencies, branches and representative offices; savings institutions, trust companies, credit unions and other financial institutions operating within New York, including mortgage bankers and brokers, check cashers, money transmitters and licensed lenders. In total, the New York State Banking Department regulates nearly $1.3 trillion in assets.

I am pleased to be here today to share our views on the need to improve disclosures and protections for users of bank-issued credit cards.

Background on Credit Cards

The widespread acceptance of credit and debit cards has been a boon to consumers, small businesses and merchants alike, offering convenient and easy access to credit for large, essential purchases. Additionally, the payment systems created by the credit and debit card systems have provided revolutionary efficiencies.

It is hard to imagine a world without those small pieces of plastic, and state bank regulators would oppose any initiatives that reduced the availability of reasonably-priced credit and convenient payment systems to qualified, responsible borrowers.

We are concerned, however, about the potential for abuse and misunderstanding as banks' competition on interest rate margins leads to ever more aggressive pursuit of fee income. Credit cards, it is clear, have become a major source of fee income for the banks that issue them.

It is in everyone's interest to make sure that abusive practices are halted wherever we identify them, and that credit card users receive information about legitimate fees that is clear, concise, timely and easily understood.

Protecting Credit Card Users

Although the Conference of State Bank Supervisors (CSBS) has not formalized any federal policy recommendations on this issue, the question of how best to protect credit card borrowers is a priority for state bank regulators, and one with broad-reaching implications for state authority, preemption and the balance of our dual banking system.

Today I would like to highlight three areas that I believe need to be acknowledged and acted on:

1) the most troubling unfair and abusive credit card practices we have identified in New York;

2) the need for a federal response to address identified abusive practices and ensure that consumers receive meaningful information about credit card terms; and

3) the important role states have played and should continue to play in protecting consumers and helping to maintain strong financial markets in their states and nationwide. Toward this issue, Congress should communicate clearly with state legislatures on what authority is and is not reserved for the states regarding financially-related consumer issues.

1. UNFAIR AND ABUSIVE CREDIT CARD PRACTICES

Credit cards are a major source of complaints for state law enforcement authorities and regulators. The New York Consumer Protection Board received 1440 credit card complaints and inquiries in 2006 and the New York Attorney General's office reported receiving an astonishing 4,000 credit card complaints in 2006 -- second only to complaints about the Internet. A February 2006 GAO report to the House Financial Services Committee on the OCC's consumer complaint processes identified credit card complaints as the number one source of complaints to the OCC, FDIC and Federal Reserve.

The good news is that credit opportunities for all consumers have expanded. The bad news, however, is that burdensome fees associated with credit cards – particularly for the majority of consumers who do not and cannot pay their credit card bills in full each month -- have skyrocketed and can cause consumers to fall deeper into debt. Early and minor mistakes in securing and using credit can lead to spiraling debt burdens, punitive fees, and the long-term destruction of borrowers' financial well-being.

In New York we have identified a number of credit card issuer practices we consider misleading or abusive. We consider these seven practices of greatest concern:

1. **Universal default**: This practice, which has been widely criticized, permits credit card issuers to increase a consumer's interest rate – often to 30% or higher – for conduct that has no relationship to the consumer's payment history with the card issuer. Such conduct includes a drop in the consumer's credit score, a late payment to another creditor, or if the consumer has too much credit. Moreover,

the information that triggers application of the default rate might not even be correct. Just recently my office received a complaint from a consumer whose credit card company increased her interest rate to 24% because of a "report" received from Experian. When the consumer checked with Experian, she found no negative report, and had an outstanding credit score of 761.

2. **Penalty rates and late fees**: Consumers are often penalized for minor transgressions. For example, a credit card payment that is only nominally late can trigger huge interest rate increases and/or over-limit fees. Higher interest rates are often applied retroactively to existing balances – not just to new purchases.

3. **Double cycle billing and other similar practices:** Many credit card issuers charge interest even for the amount of credit card debt paid on time. For example, if the credit card debt is $1,000 and the consumer only pays $500 on time, the consumer is charged interest on the full $1,000, not simply the $500 balance.

4. **Over-limit fees:** Many credit card issuers charge over-limit fees not just once but each month the debt exceeds the consumer's credit limit, even if no new transactions occur in the billing cycle.

5. **Unilateral changes in terms**. Many credit card agreements are one-sided and allow the creditor to change the terms for "any reason" with as little as 15 days notice to consumers.

6. **Deceptive promotion of subprime credit cards:** These cards target consumers in economic distress or who have troubled credit histories with deceptive solicitations that misrepresent the terms of credit and conceal the existence of excessive fees that push consumers further into debt. In 2003, New York sued one of the nation's largest subprime credit card issuers, Cross Country Bank, for engaging in fraud, deception and illegality in the marketing and collection of its subprime credit cards. Cross Country Bank's credit card solicitations represented that the recipient was specially selected and pre-approved for a premium credit card with a credit limit up to $2,500. In fact, most consumers received a credit limit of $300 that was immediately reduced by $150 in fees. Many consumers did not understand the terms of the credit card and quickly exceeded their credit limit. Indeed, more than one-third of all cardholders exceeded their credit limits and incurred additional over-limit fees within the first two billing cycles, often before receiving their first billing statement. The court found the bank's solicitations to be deceptive and ordered it to pay almost $9 million in penalties.

More recently, in 2006, the New York Attorney General reached an $11 million settlement with another subprime credit card issuer, Columbus Bank & Trust that engaged in similar practices. The settlement required the bank to improve their disclosure of fees and charges, clearly state credit lines, and reform debt collection practices.

7. **Lack of Clear Information about Credit Card Terms**

The problem is not simply a proliferation of onerous credit card terms and fees. As the GAO found in its September 2006 report on credit cards, many consumers do not understand the key aspects of their cards, including when they will be charged for late payments and what actions would cause their interest rate to increase. Consumers are often overwhelmed and confused by the complexity and length of credit card disclosures and are unaware of harmful credit card terms until it is too late. When the federal Truth-in-Lending Act first took effect in 1980, the typical credit card contract was one page long. Now many contracts are as many as 30 pages long and filled with densely worded, incomprehensible text. Therefore, it is no surprise that the GAO found that:

- Existing federally-mandated disclosures are too complicated for cardholders to understand;
- The typical credit card disclosure documents contain content that is written at a level higher than many consumers can understand;
- Credit card disclosures are not organized or presented in a manner that is easy to understand and through which consumers can readily absorb important information.

2. THE FEDERAL ROLE

State regulators all acknowledge that the OCC's and OTS's preemption of state laws has significantly limited state authority to address the issues identified above. While CSBS has not developed policy in this area regarding federal legislation, as the New York State Superintendent, I believe a strong federal response is needed. As the GAO noted in its September 2006 report, the 10 largest credit card issuers hold 90% of the outstanding balance of credit card debt nationwide. Of these 10 issuers, three are state-chartered: Capital One Financial Corp., a Virginia-based bank, Discover Financial Services, a Delaware-based bank, and American Express Centurion Bank, a Utah-based, FDIC-insured industrial loan company. With these three exceptions, states have essentially no authority to apply their consumer protection laws to the activities of the nation's largest credit card issuers.

Industry-wide, states supervise 12 of the 26 financial institutions the FDIC characterizes as "credit card banks," which means that their credit-card loans plus securitized receivables total more than 50% of their total assets plus securitized receivables. These 12 banks hold just over 22% of total assets in credit card banks nationwide; the large majority of these assets, close to 78%, are held by the 14 federally-chartered and regulated credit card banks.

Credit Card Banks: Assets by Chartering Agency

Chartering Agency	Assets (000's)	Percentage	Number of Banks
OCC	$315,516,048	77.26	12
State	$91,110,850	22.31	12
OTS	$1,763,072	0.43	2
Total	$408,389,970	100	26

Source: FDIC

A series of court decisions over the past 30 years has essentially eliminated states' ability to protect consumers from what some states have defined as abusive lending practices by lenders, other than those we directly charter. In 1978, the Supreme Court ruled in *Marquette v. First of Omaha Service Corp.*, 438 U.S. 299 that the National Bank Act allowed national banks to "export" the interest rates allowed in their home states to borrowers living in other states. This decision preempted state laws enacted to protect consumers from usurious interest rates. Eighteen years later, in the case of *Smiley v. Citibank (South Dakota), N.A.*, the Supreme Court upheld a OCC regulation that states "interest," for the purposes of this preemption, included all fees "material to the determination of the interest rate" numerical periodic rates, annual and cash advance fees, bad check fees, over-limit fees, and late payment fees.

Although the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 included specific language to provide for equal application of state consumer protection laws to the branches of national banks located in other states ("host" state branches), the OCC ruled in 1998 that this applicable-law provision did not apply to interest rates. The OCC issued an interpretive letter finding that a national bank could export the interest allowed by the laws of any state in which the bank maintained a main office or a branch.

Most recently, the Supreme Court ruled in *Watters v. Wachovia Bank, N.A.* that the independent subsidiaries of national banks are not subject to state regulation or oversight.

CSBS has vigorously resisted efforts to preempt state enforcement and protection of consumers within their borders and believes that the public is best served by a system that provides for dual federal-state regulation. Given an industry that is dominated by national bank credit card issuers and subject to the realities of federal preemption, state regulation of credit card practices is presently not a viable option. State regulation would apply only to a minority of consumers and would have the unfortunate and unintended consequence of putting state chartered entities at a competitive disadvantage. Based on court decisions it seems that the only option is for the federal government to adopt national standards to address credit card problems on a nationwide basis which would then protect all of the citizens in our states.

The Federal Reserve Board's May 23 release of proposed changes to Regulation Z, which implements the Truth in Lending Act, after a comprehensive review of TILA's rules for open-end or revolving credit, is an important step in ensuring that consumers receive meaningful disclosure of credit card terms. Our initial review of the proposed changes finds a number of valid recommendations that will improve consumer disclosure, including new disclosure format, multiple interest rates, payment allocation, penalty rates and advance notice in change of terms.

CSBS, the New York Banking Department and many other states will be reviewing the proposal in more depth and offering more specific comments. We appreciate the efforts of the Federal Reserve to revise credit card disclosure requirements in a manner that will help consumers identify information that is most important to them. Clear rules and plain-English disclosures will benefit both honest lenders and borrowers.

We are concerned, however, that credit card issuers not be permitted to perceive compliance with required disclosures as a license to engage in unfair and deceptive solicitation and other practices that confuse or mislead consumers. We also note that better disclosures, while important, are not a panacea to the problems I have outlined in the credit card industry.

3. State Efforts to Protect Vulnerable Borrowers

The third and final area I will discuss today is state efforts to protect vulnerable borrowers. In considering solutions to the problems in the credit card industry, Congress should look at the role states have played and continue to play in protecting consumers. To illustrate this, I will give three examples.

1. **States have played and should continue to play an important role in enforcement.** It is questionable whether the federal regulatory agencies have sufficient resources or incentives to adequately respond to all credit card complaints. States are closer to their consumers and their lenders, and may be better equipped to respond to the needs of both. Enforcement actions such as those brought by New York's Attorney General against Cross Country Bank and Columbus Bank & Trust for deceptive subprime credit card practices demonstrate the importance of vigilant state enforcement in combating abusive credit card practices.

2. **States have played and should continue to play an important role in developing regulatory and legislative solutions that can serve as models for federal regulation.** Creative legislative solutions often derive from state initiatives. With respect to predatory lending and subprime loans, New York has pioneered initiatives that can serve as models for federal regulation. For example, New York's high cost mortgage statute, Banking Law Section 6-l, has an affordability standard that ensures that consumers can repay loans – not just at initial teaser rates – but at the reset rate. It also prohibits various oppressive practices, including balloon payments, increasing interest rates after default, negative amortization, mandatory arbitration clauses, loan flipping and the financing of various insurance products.

In 2001 California passed a simple disclosure bill which would have, if not for preemption, caused credit card issuers to provide consumers a warning about total costs and length of time for repayment if the consumer were to only make the minimum payments.

The First Circuit Court of Appeals just affirmed the preemption of a New Hampshire law concerning gift cards issued by national banks through third parties. The New Hampshire law placed limitations on the expiration and fees that could be charged on gift cards to stop card issuers from quickly draining the balances of the cards before they are ever used.

3. **States can and should play an important role in gathering information and monitoring compliance.** When considering legislative options to reform credit card lending practices and disclosures, Congress should remember that states can play an important role in gathering information and monitoring compliance. On the state-federal front, the regulatory landscape post-*Wachovia* demands more, not less interaction.

    - One example of inter-governmental partnership is the Memorandum of Understanding (MOU) New York entered into with the OCC this past November to enhance the resolution of consumer complaints. The MOU provides for complaint referrals between the Banking Department and OCC and reflects a commitment on behalf of both agencies to share information concerning the status and resolution of complaints.
    - States are also in a position to provide valuable public information about credit card practices and the cost of credit. The New York State Banking Department publishes a quarterly survey of credit card interest rates that is available online and in hard copy upon request. The survey provides comparative information about rates, over-limit and late fees and the existence of universal default and penalty provisions for each credit card.

Conclusion

In conclusion, we believe that credit cards are a convenient method of payment for millions of Americans, and the availability of credit to Americans across income lines has undeniable benefits to individuals, households and the economy. Lending practices

that have the effect of destroying credit ratings and borrowers' financial futures, however, destabilize the economy and ultimately fly in the face of our goal, which is to make the widest possible range of safe and sound banking services available to consumers at all levels of our economy.

The Conference of State Bank Supervisors will be discussing this issue at length in the months ahead, and looks forward to sharing its views with the Federal Reserve as it continues the process of amending Regulation Z. We seek additional opportunities to work with the federal banking agencies to share best practices on monitoring compliance with consumer protection laws.

Thank you for inviting me to be here today. I would be happy to answer any questions the Committee may have.

Embargoed until
June 7, 2007, at 10:00 am

Statement of

John M. Reich, Director
Office of Thrift Supervision

concerning

Credit Card Lending

before the

Subcommittee on Financial Institutions and Consumer Credit
of the Committee on Financial Services
United States House of Representatives

June 7, 2007

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Statement required by 12 U.S.C. 250: The views expressed herein are those of the Office of Thrift Supervision and do not necessarily represent those of the President.

Testimony on Credit Card Lending
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John M. Reich, Director
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I. Introduction

Good morning, Madame Chair, Ranking Member Gillmor, and Members of the Subcommittee. Thank you for the opportunity to present the views of the Office of Thrift Supervision (OTS) on issues related to credit card lending in the thrift industry. Thank you also for your interest and leadership on this important aspect of the financial services market. According to recent Congressional testimony on the subject of credit card lending, in early 2006 there were approximately 190 million bank credit card holders in the U.S. during 2005 holding an average of seven credit cards who charged an average of $8,500.[1] The average outstanding credit card balance for American households with at least two adults who do not pay off their entire balances each month is over $13,000.[2] Clearly, credit card lending and practices are important and timely topics and I am pleased to be here to participate in this discussion and address your questions about the role of the thrift industry in credit card lending.

In my testimony today, I will discuss the thrift charter, authority for savings associations to issue credit cards and OTS authority to supervise the credit card activities of thrift institutions. I will also describe the credit card holdings of the industry and how thrifts issue credit cards, including the types of programs that are in place at various institutions. Next, I will explain how the OTS monitors and oversees the credit card activities of the industry and consumer complaints relating to credit card lending. Finally, I will address the adequacy of our authority to oversee credit card lending and provide

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1. Prepared statement of Robert D. Manning, PhD, Research Professor of Consumer Finance and Director of he Center for Consumer Financial Services, E. Phillip Saunders College of Business, Rochester Institute of Technology, Hearing on Examining the Billing Marketing, and Disclosure Practices of the Credit Card Industry, and their Impact on Consumers, US Senate Committee on Banking, Housing, and Urban Affairs, 1/25/07.

2. Ibid.

some preliminary observations on the Federal Reserve Board's (FRB) proposed modifications to Regulation Z.

II. Overview of the Thrift Charter and Thrift Credit Card Lending Authority

By statute, thrift institutions must maintain 70 percent of their assets in mortgages and mortgage-related assets; however, this requirement makes accommodation for certain retail lending activities of thrifts, including credit card lending. The purpose of this requirement and accommodation is to encourage a mortgage lending focus by thrifts, but also permit activities that are complementary to mortgage lending, such as consumer-based retail lending operations. This benefits consumers by increasing competition for these types of lending services and promotes asset diversification and balance in thrift operations by avoiding an over-reliance and overexposure to a limited and narrowly focused lending strategy.

The authority for thrifts to engage in credit card lending depends on whether the institution is state or federally chartered. The authority for state-chartered thrifts comes from state law, and the extent and scope of this authority varies depending on the jurisdiction. Generally, state chartered thrifts may engage in credit card lending, although there may be differing limits and/or other restrictions depending on the state.

The authority for federal thrifts to engage in credit card lending derives from the Home Owners' Loan Act (HOLA). Pursuant to the HOLA,[3] a federal savings association may invest in, sell, or otherwise deal in loans made through "credit cards or credit card accounts" without limitation as a percentage of assets to the extent specified by OTS regulations. OTS regulations permit federal thrifts to issue credit cards and maintain credit card accounts,[4] but impose no general limitation on credit card lending by federal thrifts. By regulation, however, the OTS may establish an individual limit on such loans if the agency determines that an institution's concentration in such loans presents a safety and soundness concern.[5]

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3. 12 USC § 1464(c)(1)(T).

4. 12 CFR § 560.3. Pursuant to this provision, a credit card is defined as "any card, plate, coupon book, or other single credit device that may be used from time to time to obtain credit." A credit card account is defined as "a credit account established in conjunction with the issuance of, or the extension of credit through, a credit card." These terms include loans made to consolidate credit card debt, including credit card debt held by other lenders, and participation certificates, securities and similar instruments secured by credit card receivables.

5. 12 CFR § 560.30.

III. OTS Authority to Supervise Thrift Credit Card Lending Activities

The general authority for federal thrifts to issue credit cards is subject to the authority of the OTS to supervise thrift credit card lending activities. OTS authority includes the ability to examine, regulate and, as noted above, limit for safety and soundness reasons the credit card operations of federal thrifts.[6] Pursuant to its authority to oversee the activities and operations of a federal thrift, the OTS is authorized to regulate, oversee and limit the credit card operations of a federal thrift that are in violation of consumer protection laws and/or that the agency determines pose a reputation risk – and thus a potential safety and soundness risk – to an institution.

IV. Thrift Industry Credit Card Holdings and Programs

A. Industry Holdings

As of March 31, 2007, OTS-regulated thrifts had total credit card holdings of $40.59 billion, or 2.7 percent of aggregate thrift industry assets. This amount represents approximately 11.5 percent of the aggregate $354.2 billion of credit card holdings of all FDIC-insured depository institutions. Eight OTS-regulated thrifts reported over $1 billion in credit card balances as of March 31, 2007. These institutions reported $39.56 billion outstanding, representing the vast majority (97.5 percent) of thrift industry holdings. By contrast, the remaining 126 thrift institutions that reported some level of credit card balances accounted for only $1.03 billion, or 2.5 percent of thrift industry credit card holdings. The industry-wide concentration in credit card holdings is further evident in that the 10 largest thrift credit card programs comprised 98.7 percent of thrift industry holdings.

On an aggregate basis, unused consumer credit card lines at OTS institutions totaled $618.8 billion in March 2007, up from $607.4 billion one-year prior. This represented 14.3 percent of the unused balance of $4.32 trillion of consumer credit card lines reported by FDIC-insured institutions as of March 31, 2007.

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6. Section 4(a) of the HOLA, 12 USC § 1463(a), provides that the OTS Director shall provide for the examination, safe and sound operation, and regulation of state- or federally-chartered savings associations. It further provides that the OTS may issue such regulations as the Director determines to be appropriate to carry out its responsibilities. In addition, HOLA section 5(a), 12 USC § 1464(a), provides that the OTS Director may prescribe the organization, incorporation, examination, operation, and regulation of federal savings associations. Finally, as previously noted, the OTS has specific authority to regulate the credit card activities of federal thrifts pursuant to HOLA section 5(c), 12 USC § 1464(c)(1)(T), which provides that a federal thrift may engage in credit card lending to the extent specified by OTS regulations.

Seventeen thrift institutions had credit card loan balances in excess of 10 percent of their risk-based capital. Nine of these institutions had credit card concentrations exceeding 100 percent of risk-based capital. Notwithstanding these levels, issuers continue to have strong capital positions supporting their credit card lending programs.

After showing some trends towards increasing delinquencies over the past few quarters, industry credit card delinquencies improved slightly in the first quarter of 2007. Credit card balances with payments between 30 and 89 days delinquent were 1.56 percent during the quarter, and balances 90 days past due were 1.44 percent. However, there was a continued increase in the level of charge-offs by OTS-regulated credit card lenders during the quarter. On an aggregate basis, adjusted net charge-offs were $540.4 million for the quarter, representing a 13.5 percent increase from the prior quarter. Although the level of increasing charge-offs warrants increased regulatory attention, the industry is coming off of historical low charge-off levels from one year ago. With the resolution of seriously delinquent credit cards, we expect that recent increases will moderate, but we are closely monitoring this area.

B. Industry Programs

Thrifts with significant credit card programs utilize various marketing channels, including:

- direct mail solicitations;
- partnership agreements with companies that make referrals on potential customers;
- retail marketing to customers; and
- branding so-called "private label credit cards" for consumer retailers that serve customers directly.

Of these, certain issuers also have programs that include products that are marketed to subprime borrowers. While these programs, in particular, present some supervisory challenges, issuers are generally responsive and focused on potential compliance problems arising from the marketing and servicing of subprime accounts. As described below, the OTS monitors these programs closely.

V. OTS Monitoring and Oversight

In addition to quarterly monitoring of the loan levels, performance and capital adequacy of thrifts engaged in credit card lending programs, the OTS monitors the marketing, pricing, fee and servicing practices of these programs. An important component of our oversight is examining for compliance with consumer protection laws, and particularly the account management and collection activities and practices of these institutions.

The OTS has a dedicated team of credit card specialists known as the Core Credit Card Specialty Group that works on continually improving our examination staff knowledge base, effectiveness, and inter-regional training program with respect to credit card oversight. Our Core Group staff assists our regional examiners in the review of our most complex credit card institutions and enhances cross-training efforts and the consistency of these examinations. Staff at the national office prepares specific quarterly monitoring reports and assigns core teams to assist in key selected institutions. For the thirteen institutions that have significant credit card operations, we currently have four examiners assigned to this core group. The group focuses on the major functional areas involved in credit card lending, including marketing, underwriting, account management, and collections activity.

We also have a consolidated examination structure that is unique among the federal banking agencies. This program, which has been in place for approximately four years, combines our safety and soundness and compliance examinations to better assess institution risks during the examination process. We have found that it also improves the assessment of risk within the industry and provides examiners with a broader examination perspective as well as broader developmental opportunities. And from a regulatory burden perspective, it is less intrusive to our institutions to have a combined safety and soundness and compliance exam, than to have two separate exams every exam cycle.

Part of the underlying rationale for this melded examination approach is that we believe compliance and safety and soundness should go hand in hand at an institution. Our examination teams have been conducting joint examinations and issuing one examination report for safety and soundness and compliance matters for the past several years. We believe this provides a more comprehensive assessment of an institution's risk profile and more accurately exposes weaknesses and deficiencies in an institution's overall program. Examining an institution's compliance with consumer protection laws and regulations along with its overall safety and soundness also provides us with an accurate assessment of an institution's overall business strategy.

Our safety and soundness and compliance examiners are subject to an intensive cross-training program to acquire the full knowledge and skills needed to lead melded examinations. We also maintain a cadre of compliance experts to assist examination teams in handling complex compliance matters. And our program staff has produced combined examination procedures, policies and handbook manuals that support this melded examination approach. The majority of responses from institutions have been overwhelmingly favorable regarding this examination format.

As set forth in OTS examination guidance,[7] OTS examiners look at all of the following areas in evaluating an institution's credit card lending program:

- subprime lending, marketing and servicing activities;
- credit scoring models used by thrifts to set applicable rates and fees;
- the existence of any unfair or deceptive acts or practices in the marketing or servicing of credit card accounts;
- compliance with Truth in Lending Act disclosure requirements;
- credit card collections and workout activity;
- delinquency, classifications, and charge-off policies;
- institution risks and controls (including fraud control) with respect to credit card lending activities;
- underwriting and account acquisition standards; and
- general account management and servicing procedures.

Because federal thrifts may conduct credit card lending programs subject only to the requirements of federal law, the OTS is required to ensure that federal thrifts conduct their credit card lending activities and programs in compliance with applicable consumer protection laws and subject to rigorous scrutiny of all aspects of an institution's program. In conducting its oversight of federal thrift credit card lenders, the OTS is particularly mindful of reputation risks that could undermine the safety and soundness of an institution and/or the federal thrift charter out of which an institution conducts its credit card operations.

As part of our examinations, we regularly examine thrifts for compliance with federal consumer protection statutes including the Truth in Lending Act and fair lending laws such as the Equal Credit Opportunity Act. We examine for compliance with our advertising regulation, which prohibits thrifts from making any representation that is inaccurate or that misrepresents its services, contracts, investments or financial condition.[8] We also examine thrifts for compliance with our nondiscrimination regulation, which prohibits thrifts from discriminating in lending and other services, appraisals, marketing practices and related areas.[9] Finally, long-standing OTS guidance provides that a thrift's collection activities must comply with the following:

- state laws that pertain to collection and foreclosure actions; and
- bankruptcy law – an institution's collection activity is affected by any bankruptcy plan into which a debtor has entered.

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7. Section 218, OTS *Examination Handbook.*

8. 12 C.F.R. § 563.27.

9. 12 C.F.R. Part 528.



An area of particular scrutiny with respect to credit card management practices in recent years is the application of minimum amortization standards by credit card lenders. Pursuant to guidelines issued by the federal banking agencies, credit card lenders are expected "to require minimum payments that will amortize a current loan balance over a reasonable period of time, consistent with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness."[10] The banking agencies also noted that prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt and disguise portfolio performance and quality raise safety and soundness concerns and are subject to examiner criticism.

OTS examiner guidance provides a more explicit interpretation of the interagency amortization guidelines, stating that "monthly payments should cover at least a one percent principal balance reduction, as well as all assessed monthly interest and finance charges."[11] Both the interagency credit card guidance and OTS examiner guidance allow for exceptions within well-managed credit card programs, consistent with prudent underwriting. While OTS-regulated thrifts vary slightly with respect to application of the one percent guideline, there are no cases currently outstanding where institution practices are unreasonable.

A. Consumer Complaint Activity

The OTS continually tracks, investigates and responds to consumer complaints involving thrift institutions with respect to product offerings and services, including credit cards. Consumer complaint staff and managers also prepare summaries of consumer complaints for OTS examiners to utilize in their reviews during on-site examinations.

We are also currently in the process of finalizing with the Conference of State Bank Supervisors (CSBS) a model memorandum of understanding (MOU) that we will be able to implement with various state banking supervisors to facilitate the sharing of consumer complaint data between the OTS and the states. The MOU is intended to promote the sharing of individual complaints for processing by the appropriate agency. It also provides for periodic reports of the number of complaints forwarded to the states or the OTS, the disposition of such complaints and other summary information. We have been working closely with the CSBS on this effort, and it is my understanding that the MOU will be finalized soon.

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10. Interagency Credit Card Lending, Account Management and Loss Allowance Guidance, January 8, 2003.

11. Section 218, OTS *Examination Handbook.*

Institution consumer complaint records are an integral part of the OTS individualized Pre-Examination Response Packages (PERK), which is our request to thrifts for data that will be used during the examination. This data plays a significant role in identifying areas for examiners to focus on during on-site examinations. These records also play a critical role in assessing the adequacy of an institution's overall compliance management program and in pursuing corrective action that may be appropriate to address programmatic weaknesses or deficiencies.

Specific complaint activity for particular institutions engaged in credit card lending varied considerably over the past year. Not unexpectedly, the largest issuers generally received higher numbers of consumer complaints. By contrast, the remaining institutions generated relatively few complaints in this area. The most frequent complaints related to credit card underwriting and credit bureau reporting. Typically, complaints in this area arise from Equal Credit Opportunity Act notices consumers receive because their application for a credit card or request for an increase in their credit card limit is declined.

Other common complaint areas involved billing errors; late fees and over limit fees; consumers' challenges to the accuracy of the annual percentage rate (APR) and finance charges arising from how the APR was calculated; customer service and consumer relations issues; collections activity; and problems encountered by consumers attempting to close a credit card account.

In addition to using consumer complaint data in connection with the supervisory oversight and examination of an institution, the OTS follows up with the institution on all consumer complaints filed with the agency. We impose a 60-day timeframe for the handling of consumer complaints by OTS staff and, in order to meet that goal, we work with thrifts promptly to request information needed to process and resolve a complaint. Due to the complexity of some complaints and related factors, it is not always possible to resolve a complaint within the designated timeframes; however, we track our response time closely. We typically process and conclude consumer complaint investigations within our designated timeframes. From January 2005 through May 2007, OTS staff processed and closed 94 percent of all consumer complaints we received within the designated 60-day timeframe.

Generally, we encourage institutions to work directly with consumers to attempt to resolve a complaint; however, OTS staff will become involved, when appropriate, to attempt to resolve a matter to the satisfaction of a consumer. We will also advise a consumer, upon completion of our review, if we believe that there is not a basis for the agency to compel the institution to take action or if it is our view that the institution properly handled the matter that generated the complaint. The OTS handles each

consumer complaint separately based on the facts and circumstances upon which the complaint is based.

It is important to note that our consumer complaint policy provides that even when evidence does not reveal regulatory violations, OTS complaint analysts and management have the flexibility and authority to encourage thrifts to take voluntary action to satisfy a consumer, where circumstances warrant such action. This happens fairly frequently in the interest of preserving strong customer relationships and further enhancing the reputation of thrifts as essential providers of financial services.

B. OTS Enforcement Activities

When an institution's lending programs are found to be potentially predatory or lacking adequate controls to support responsible lending, there are numerous options that the OTS can take to eliminate these risks. These include informal agreements, supervisory directives, board resolutions, and various other approaches. Our jurisdiction and oversight of an institution's lending programs also extends to the holding companies, affiliates, service providers, and other contractual relationships that an institution may utilize to conduct its credit card activities and related operations.

For example, we recently addressed an issue with an institution engaged in what we viewed as a potentially abusive subprime credit card lending program. The nature of the program was uncovered in the normal course of an examination. In connection with the resolution of that matter, we directed the institution's board of directors to establish a systematic process to withdraw from the subprime credit card program, and immediately cease new approvals under the program.

Although this was a more informal action pursued in the course of an examination, the result was that the program's growth was immediately terminated, and the program itself was unwound within a reasonably short timeframe following the examination. We have taken similar actions with other institutions in the past.

We have also exercised our enforcement authority outside of the credit card context to address transactions in which an institution enters into an agreement with an affiliated entity to originate and fund problematic loans through the institution. The OTS intervened in this matter after agency examiners determined that the thrift was not managing the relationship appropriately, insufficient controls were in place to fully ensure effective lending practices, and there was an indication of potentially abusive lending practices. In response, the OTS issued supervisory directives and required board resolutions to address the problem, including termination of the relationship between the thrift and the affiliated entity.



In other instances, the OTS has used a combination of formal and informal enforcement actions to force the discontinuation of lending operations by federal thrifts that were attempting to exploit the charter to engage in lending programs lacking adequate consumer protections and management controls. Some cases referred to as "charter rental" strategies involve situations where an institution is attempting to avoid state oversight of out-of-state lending activities by the institution. In addition to raising significant consumer protection issues, these situations not only expose the institution to potential risks, but undermine the integrity of the federal thrift charter. The OTS is particularly vigilant in intervening and expeditiously shutting down these types of operations.

There are numerous other such examples of actions taken by the OTS in the course of examinations of the institutions we regulate. While we find informal actions to be an effective mechanism to address these types of supervisory concerns, we do not hesitate to use our formal enforcement authority when appropriate to do so. Fundamental to our continuing oversight of the industry we regulate is ensuring that institutions conduct their activities in a manner consistent with sound consumer protection.

C. OTS Examiner Consumer Compliance Test

Pursuant to our program for monitoring and oversight of consumer protections, the OTS recently developed a new examination that is used to test and train OTS examiners regarding their level of proficiency across a broad range of consumer compliance laws and regulations. While we have always tested our examiners in this area, we developed this in-house examination to continue to ensure that OTS examiners have significant knowledge regarding consumer compliance requirements and agency expectations of the institutions that we regulate. The new test will assist us in working with our examiners to develop professionally to effectively examine thrift institutions, many of which have complex, retail-focused business models.

VI. Adequacy of Existing OTS Authority

As described above, I believe that the OTS has adequate existing authority to address the types of issues and potential abuses that may arise with the credit card lending programs of OTS-regulated thrifts. I do not feel that additional statutory authority is necessary at this time for the agency to continue effectively to supervise and regulate the credit card lending activities and practices of the thrift industry. At such time as a need should arise, I assure you that we will advise the Chair and Members of the Subcommittee of the need for legislative assistance to address any deficiency in our ability to supervise and/or respond to thrift credit card lending practices that pose consumer protection, safety and soundness, or other risks to the federal thrift charter.



VII. Proposed Revisions to Regulation Z

The Truth in Lending Act (TILA) enhances the information available to consumers regarding the cost of credit. Such information enables consumers to shop and compare credit options based on price and related terms. TILA also includes procedural and substantive provisions to protect consumers against inaccurate and unfair credit billing and credit card practices. TILA is implemented by the FRB's Regulation Z, which the FRB recently proposed revising.

In connection with the FRB's proposed revisions to Regulation Z, you have asked us to address a number of questions, including:

- What aspects of the FRB's proposal, if any, represent a significant improvement in consumer disclosure?
- Is the FRB's proposal sufficient to protect consumers in light of current credit card fee assessment, marketing, and other practices?
- What further measures should be considered?
- To what extent do issuers still use universal default, double-cycle billing, and retroactive rate increases?
- Has industry developed best practices and if so what are they?
- Have industry reforms been implemented for "subprime" credit card holders as well as "prime" customers?
- Is more information gathering needed regarding threats to consumers from "subprime" credit cards, and how can that be accomplished?

Given that the FRB's proposal is out for public comment and has not yet been published in the Federal Register, I do not think it appropriate to provide public comments on the specifics of the proposal at this time. I will, however, provide some general observations.

The FRB's proposed changes to Regulation Z apply to open-end credit not secured by a home. The FRB's proposal would amend aspects of Regulation Z pertaining to application and solicitation disclosures; account-opening disclosures; periodic statement disclosures; change-in-terms notices; and advertising provisions.

The OTS commends and supports the FRB on the comprehensive proposed amendments to Regulation Z. The proposed changes are the result of exhaustive and comprehensive analysis. In addition, the proposed new disclosures were the result of consumer testing and focus groups to determine readability and clarity for typical consumers. Clearly, and most importantly, the proposed overall changes were designed to enhance consumers' informed use of credit. As the FRB reviews the proposal, I would also encourage consideration of ways to address the cumulative impact of additional regulatory burden, particularly on smaller institutions, under the proposed rule.



The most significant changes in the proposal address:

- **Applications and Solicitations** – These changes would establish a new format for the "Schumer box"/summary table and include related changes designed to draw consumers' attention to key information. The proposed changes also require that creditors disclose the duration that penalty rates may be in effect, a shorter disclosure about variable rates, and new disclosures highlighting the effect of creditors' payment allocation practices (so consumers know how their payments will be credited and applied).

- **Account Opening Procedures** – These proposed changes would modify existing fee disclosure requirements to provide greater clarity for identifying and presenting fees that must be disclosed. The changes would also give creditors the option of disclosing charges (other than those required in the Schumer box) verbally or in writing.

- **Periodic Statement Disclosures** – These changes would group fees, interest charges and transactional information together to make the information easier to follow. The changes would also require disclosure of the effect of making only minimum payments.

- **Changes in a Consumer's Interest Rate and Other Account Terms** – The proposed change would increase from 15 days to 45 days the length of time that an institution must wait after giving notice to a consumer that the institution is changing the terms of credit. In addition, creditors would have to provide 45 days notice to a consumer before increasing the interest rate on an account due to a consumer's delinquency or default. These changes would allow borrowers more time to shop around for alternatives.

- **Advertising** – The proposal would require finance plan advertisements to display with equal prominence the minimum payment, the time period required to pay the balance, and the total of the payment if only minimum payments are made. In addition, ads referring to a "fixed" rate must specify the time period for which the rate is fixed and that the rate will not increase for any reason during that time. And if a time period is not specified, the rate would not be able to increase for any reason while the plan is open.

Generally, the most significant aspects of the FRB's proposed revisions to Regulation Z are those that provide consumers with more time, better practical disclosures, and more comparative information upon which to make important credit decisions. We certainly support the intent of these modifications and will more closely

review the proposal during the public comment period, and we look forward to reviewing the public comments submitted on the proposal.

Apart from an analysis of the FRB's Regulation Z proposal, it is worth noting, as previously observed, that thrifts engaged in significant credit card lending programs have taken the initiative in recent years to address many of the issues raised by the Subcommittee, including with respect to credit card fee assessment, marketing, and related practices. And we are working with the institutions we regulate to continue to encourage the development and use of best practices, where appropriate, with respect to credit card lending, pricing, fee setting, marketing, servicing, and collection practices.

We look forward to working with the FRB and the other banking agencies to address the issues raised in the FRB's Regulation Z proposal, as well as aspects of our current system that are not a subject of the proposal. In particular, we are pleased to be a part of this dialogue on existing credit card practices within the industry, and we look forward to a productive and ongoing dialogue on addressing issues such as double-cycle billing, universal default, and existing standards and safeguards available to subprime credit card borrowers.

VII. Conclusion

While credit card lending programs are not prevalent throughout the OTS-regulated thrift industry, there are a number of institutions that engage in significant amounts of credit card lending. For our part, we will continue to work with our institutions to ensure safe and sound underwriting standards and strong consumer protections that benefit both the institutions that we regulate and their customers. We will continue to monitor the revisions to Regulation Z proposed by the FRB, and support efforts to further strengthen the ability of consumers to make informed decisions with respect to their credit card accounts.

I applaud you, Madame Chair and Ranking Member Gillmor, for holding this important hearing on the credit card practices of banks and thrifts. Thank you for the opportunity to present the OTS's views on these issues.

*****



June 6, 2007

The Honorable Carolyn Maloney
Chair
Subcommittee on Financial Institutions
and Consumer Credit
House Financial Service Committee
United States House of Representatives
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Paul Gillmor
Ranking Member
Subcommittee on Financial Institutions
and Consumer Credit
House Financial Services Committee
United States House of Representatives
B371A Rayburn House Office Building
Washington, DC 20515

Dear Chair Maloney and Ranking Member Gillmor:

I am writing on behalf of the National Association of Federal Credit Unions (NAFCU), the only national trade association that exclusively represents the interests of our nation's federal credit unions, in conjunction with your hearing this Thursday entitled "Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives" to share our comments on this important issue.

Federal credit unions have maintained an impeccable record of providing consumer-friendly credit card products. As member-owned and controlled financial institutions, federally chartered credit unions are unique because the products offered are aimed solely to benefit the members of the credit union. An extensive regulatory framework is also in place to ensure the safety and soundness of all lending practices that federal credit unions perform, including open-end credit granted through credit cards. NAFCU strongly believes that credit unions' customer first approach, a strong sense of accountability to members, and the regulatory framework are primary reasons that delinquency rates of credit union members using credit union issued credit cards are comparatively lower and overall credit card performance is stronger.

Currently, approximately 50 percent of all federally insured credit unions offer their members credit card service. The growth rate of credit card lending by credit unions has averaged over 4 percent for the last five years, representing just over 5 percent of the total loan portfolio of credit unions. The average interest rate of all the federally insured credit unions offering credit card services today stands at 11.38 percent. Furthermore, interest rates for credit cards offered by credit unions are capped at 18 percent because of the statutory usury ceiling on credit unions. When compared to the 27 percent and above rates other credit card issuers charge, it is no surprise that past due credit cards rates for credit unions are substantially lower than non-credit union lending institutions.

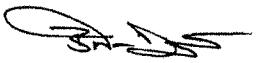
Additionally, consumer complaints in regards to credit card services provided by federal credit unions reveal relatively few problems. A NCUA monitored and enforced complaint resolution process for credit union members is also a key aspect of allowing credit unions to be member friendly when it comes to credit card lending. The NCUA has strict guidelines that help credit

unions favorably resolve any issues that a member may have in regards to credit union lending practices. When a violation is filed, NCUA examiners develop and communicate corrective actions to the credit union in question and help negotiate prompt corrective solutions between the member who has filed the complaint and the credit union. Furthermore, credit unions are known to have more consumer-friendly disclosures and rates.

In addition to the regulatory environment that is aimed at creating very sound credit card lending practices, another member-oriented service in which numerous credit unions throughout the country proudly participate is financial education. These programs have been instrumental in teaching practical money management skills to credit union members and have further ensured that the relationship between lender and borrower will be a successful one. These are just a few examples demonstrating the benefits credit unions provide their members over and above what other credit card issuers provide their customers. It is also evidence as to why credit unions have been so successful at creating a sound environment when it comes to credit card lending practices.

In conclusion, NAFCU would like to thank you for holding this hearing and for the opportunity to comment on it. We believe that credit unions have taken extensive measures to ensure customer satisfaction and to foster a safe and sound environment for credit card lending. NAFCU looks forward to working with you and the Subcommittee as you address this important issue. If you or your staff have any questions regarding this matter, please don't hesitate to call NAFCU's Director of Legislative Affairs, Brad Thaler or me at 703-522-4770.

Sincerely,



B. Dan Berger
Senior Vice President-Government Affairs

cc: Members of the Subcommittee on Financial Institutions and Consumer Credit

STATE OF NEW YORK
EXECUTIVE DEPARTMENT
STATE CONSUMER PROTECTION BOARD

Eliot Spitzer
Governor

Mindy A. Bockstein
Chairperson and Executive Director

Testimony Submitted by Mindy A. Bockstein, Chairperson and Executive Director of the NYS Consumer Protection Board

Before
Congresswoman Carolyn Maloney (D- N.Y.)
Chair, Subcommittee on Financial Institutions and Consumer Credit
Washington, D.C.
June 7, 2007

In the Matter of
Improving Credit Card Consumer Protection

Testimony to Examine the Credit Card Industry, and their Impact on Consumers.

I. Introduction

I wish to thank Congresswoman Maloney for holding this hearing on such a timely and important issue. I look forward to the opportunity to work with the Congresswoman and her colleagues to address credit card practices and disclosure issues.

The New York State Consumer Protection Board (CPB) was established in 1970 pursuant to Executive Law Sections 552 and 553. It is the mission of the CPB to protect, educate and represent

consumers. The CPB is experiencing programmatic, technological and staffing changes and has been reorganized with the goal of more effectively reaching consumers with informational and educational programs and policy development. Two (2) of our newly reconstituted bureaus are relevant to today's discussion.

The Outreach and Program Development Bureau is developing comprehensive consumer education and information programs on issues such as identity theft, Internet safety, financial literacy and credit card management. This bureau is inclusive of our Consumer Assistance Unit (CAU) which takes complaints five (5) days a week, 8:30 a.m. to
4:30 p.m. via our toll free helpline at 1-800-697-1220 and twenty-four (24) hours a day, seven (7) days a week via the web at www.nysconsumer.gov. The CAU responds to and resolves over 20,000 complaints and inquiries a year on a variety of topics including product refunds and returns, home improvement and credit card disputes.

From 2006 to the present, the agency received over twenty-one hundred (2,100) credit card related complaints and inquiries. The nature of these complaints includes billing disputes and erroneous charges, exorbitant fees, changes in interest rates and late payment fees. We have successfully mediated, resolved and satisfied over eight hundred (800) of these inquiries.

The Counsel, Policy and Research Bureau is responsible for the agency's legal functions including, enforcing the New York State Do Not Call Law; managing the Security Breach Notification Law as it applies to the CPB; drafting and implementing our legislative programs; conducting investigations and public hearings; developing policy; filing comments on State and federal consumer issues; and, collaborating with federal and local consumer protection agencies. This bureau includes our Public Information Unit which is responsible for cultivating media partnerships, issuing press releases

and disseminating CPB consumer messages and alerts.

The CPB is expanding its focus to analyze and address new consumer issues and topics using a variety of tools. Additionally, our staff is mediating and resolving a larger volume of consumer complaints and offering more helpful information in response to consumer inquiries. We intend to propose and support proactive legislation that creates necessary administrative remedies for consumers. In serving as the consumer "think-tank" and "watchdog" for the State, the CPB plans on developing stronger public and private partnerships, initiating policy development, crafting innovative responses to consumer problems, and providing New Yorkers with greater access to the information and tools they need to make educated marketplace decisions.

II. Background/Cases

The credit card industry is a growth industry and it shows no signs of slowing down. According to Robert Manning, Research Professor of Consumer Finance and Director of the Center for Consumer Financial Services at the Rochester Institute of Technology, nearly seventy-five percent (75%) of U.S. household members have a bank credit card, up from fifty-four percent (54%) in 1989. Between 1980 and 2005, consumers increased their yearly credit card charges from an estimated $69 billion per year to more than $1.8 trillion. This has resulted in an increase in household debt, which grew from $59 billion in 1980 to approximately $880 billion in 2007. In an article by CNNMoney.com, it was reported that the average American household has almost $10,000 worth of credit card debt. From 1978 to 1996, consumer credit card debt grew from $50 billion to $378 billion, multiplying six-fold. In 2004, the Federal Reserve estimated that American consumers carry approximately five (5) credit cards each.

The credit card industry looks much different than it did when it first started over five (5)

decades ago. In 1950, Diners Club introduced the first general-purpose charge card. This card enabled consumers to purchase goods and services from different merchants. However, because it was a charge card, it required the cardholder to pay off the balance every month. Subsequently, during the late 1950's, Bank of America (BOA) offered the first widely available general-purpose credit card, in which the balance could be paid over time and the cardholder had a credit limit.[1] Around 1966, to increase the number of consumers carrying the card and to reach retailers outside of BOA's area of operation, other banks were given the opportunity to license BOA's credit card. As the network of banks issuing credit cards grew, administrative operations were spun off into two separate credit card entities known today as VISA and MasterCard.[2]

Visa and MasterCard developed the infrastructure for a nationwide credit card payment system. However, these companies were bound to comply with state usury laws which prevented credit card lenders from reaping all the benefits of the nationwide system.

The regulated credit card environment dramatically changed in 1978 with the landmark decision in *Marquette National Bank of Minneapolis v. First Omaha Service Corp.* ("Marquette") 439 W.S. 299 (1978). The Court held that a lender can charge the highest interest rate allowed in the lender's home state, regardless of usury laws in the consumer's state. This acted as a means for federally-chartered banks to export interest rates from their home states across state lines.[3] This enabled national banks to establish their headquarters in states that either raised or eliminated usury limits, granting banks

1 Ackerman, J.M. 1981. Interest rates and the law: a history; Arizona State Law Journal 27; Analysis of Emerging Risks in Banking, 1998.
2 Id.
3 Testimony before the committee on Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations regarding Credit Card Practices: Fees, Interest Rates and Grace Periods. Presented by Alys Cohen, Staff Attorney National Consumer Law Center, March 7, 2007.

free rein to charge whatever interest rate it wanted across the country.[4]

The *Marquette* decision allowed credit card issuers to charge the highest interest rates to any consumer throughout the country. *Marquette* ushered in the deregulation of usury ceilings on consumer interest rates by allowing lenders in a state with liberal usury ceilings to export those rates to consumers residing in states with more restrictive usury ceilings.

Then, in 1996, the Supreme Court reinforced the *Marquette* decision and clearly defined the parameters for the credit card industry in *Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735 (1996). In *Smiley*, the court approved a definition of interest that included a number of credit card fees applicable to late payments, going over the spending limit, taking a cash advance, dishonored payments, and membership.[5] This allowed national banks to charge their customers fees in any amount, under any category, as long as their home state's laws permitted it. *Smiley* set the stage for an increase in credit card fees, and clearly reinforced the ability of credit card issuers to charge multiple fees.

The actions of the credit card industry and its impact on consumers has not gone unnoticed. In October 2001, California passed the California Credit Card Payment Warning Act requiring card issuers to follow a specific set of procedures if the agreement allowed customers to make monthly payments of less than ten percent (10%) of the outstanding balance. The noteworthy requirements included printing a minimum payment warning on billing statements and showing how long balances of various sizes would take to be paid off if only the monthly minimum payment was made. However, in 2002, *American Bankers Association v. Lockyer,* 239 F.Supp. 2d 1000 (2002), held that federal law preempted California's minimum payment disclosure requirement. The Court stated, "consumer protection is not reflected in the case law as an area in which the states have traditionally been permitted

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4 Id.

to regulate national banks." This renewed the federal government's position restricting the states' ability to govern terms of credit or mandate disclosures and content in billing statements.

It is through these court decisions that credit card companies have been able to offer appealing "incentives" while hiding the true costs associated with using a credit card. Credit card companies profit not only by charging interest but also from assessing transaction fees on merchants and various fees on consumers including late, over spending limit, cash advance, ATM, stop payment, telephone payment, and expedited payment. Prior to about 1990, credit cards were offered with annual fees, a relatively high fixed interest rate and low penalty fees, compared with average rates and fees being assessed today.[6]

Today, although many credit cards offer lower interest rates, most of them assess higher and more complex user fees. For example, a common fee is the late fee. According to CardWeb.Com, Inc., credit card late fees rose from an average of $12.83 in 1995 to $33.64 in 2005, an increase of over 160 percent (160%). The Government Accountability Office (GAO) reported that the average late fee penalty was $34, a one hundred-fifteen percent (115%) increase from 1995. In 2005, about thirty-five percent (35%), over one-third of active accounts, were assessed a late fee at least once. Adding numerous fees to an existing balance perpetuates consumer debt and enables companies to sometimes triple the original amount borrowed and expand its bottom line. Understanding these fees and having mechanisms available to consumers to specifically support their questions regarding contract terms, conditions and fees, is vital to their ability to understand the implications of the credit card agreements in which they enter.

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5 Id. at 3. The OCC definition of interest is found in 12 C.F.R. § 7.4001(a).
6 Government Accountability Office report, p. 18. *Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosures to Consumers*.

In the pursuit of optimizing profits and increasing retail banking, financial institutions and retailers enhanced their consumer marketing efforts and directed credit card operations toward more marginal and financially insecure populations including college students, seniors and the working poor. The pressure to increase profits has actually raised the cost of borrowing on consumer credit cards. Financial mergers and acquisitions, has decreased competition and consumer choice. The GAO report states that in 1977, the top fifty (50) banks accounted for about one-half of the credit card market. At the beginning of 2006, the top three (3) card issuers (J.P. Morgan Chase, Citigroup, Bank of America) controlled over 61.8 percent of the market as defined by their proportion of outstanding credit card debt.

III. Recommendations

Consumers are at a disadvantage because often times, the real cost for the use of the credit card is hidden. Issuers entice consumers with promises of special no-interest introductory rates, low interest rates and rewards programs. However, the fees and contract terms are confusing and often times, not prominently displayed. Consumers are then blindsided by the confusing terms and the conditions under which fees are applied causing them to fall into a cycle of debt.

The CPB acknowledges that many of the practices used by credit card issuers perpetuate credit card debt. We agree with the concerns outlined in the 2006 GAO report, "Credit Cards: Increased Complexity in Rates and Fees Heightens Need for More Effective Disclosure to Consumers." The following is an outline of those concerns and the CPB's recommendations for change.

1. **Universal Default Clauses**: Credit card lenders use this contract clause to enable them to impose penalty interest rates because the consumer was late in paying other creditors. Even if the consumer had a perfect history of on-time payments with the credit card issuer, the default on another line of credit triggers an increased Annual Percentage Rate (APR). In addition to default with another creditor, a drop in credit score can trigger the same penalties.

Recommendation: While some industry participants have indicated that they have eliminated this practice, the CPB recommends prohibiting the use of universal defaults.

2. Penalty Rates: Penalty rates are increases in the APR for a credit card. The increase in APR is triggered by events such as late payments or exceeding the credit limit on the card. Even if the credit limit is exceeded as a result of an imposed issuer fee, the APR may be increased by thirty percent (30%) to forty percent (40%).[7] Additionally, the increased APR is not a prospective penalty. It is often applied to the old balance and far exceeds the originally agreed upon rate.

Recommendation: The CPB recommends a national usury rate established by the federal government. Also, the CPB calls for prohibiting over-the-limit fees if the issuer does not deny a purchase transaction and permits the credit limit to be exceeded or imposes a fee causing the credit limit to be exceeded.

3. Late Payment Triggers: Most credit card companies assess late fees. Credit card issuers were once more forgiving, permitting a grace period of a few days, but now fees are often imposed even if the payment is one day late. Even if the payment is received in a timely manner, if it is not posted to the account by the due date, the payment will be considered late. In addition, if the payment date falls on a weekend or holiday, and the payment is not received by the prior business day, the payment may be considered late and the consumer may be assessed a fee and possibly an increased APR. In 2005, about thirty-five percent (35%), over one-third of active accounts, were assessed a late fee at least once.

Recommendation: The CPB calls for credit card issuers to use the postmark date as the date of receipt of payment. This is the method used by the Internal Revenue Service (IRS).

4. Unilateral Change-in-Terms: The unilateral ability of credit card issuers to change contract terms renders the contract with the consumer a contract of adhesion; that is when one of the contracting parties has little or no bargaining power and the other side has total control over the terms. Issuers can change any term of the contract with only a 15-day notice according to the Truth in Lending Act (TLA).

Recommendation: The CPB recommends that consumers be given at least 30-days to review the terms to determine if they will accept. The CPB suggests that credit card issuers provide consumers with a conspicuously placed and easily distinguishable opt-out option for consumers. In addition, consumers should be given a toll-free number dedicated to answering questions regarding the change in terms and its implications.

5. Subprime Credit Cards: Subprime credit cards give people access to credit who

7 Id. at 3.

have low credit scores, little or no credit history and those emerging from bankruptcy or have a questionable credit history. The limited number of consumer protection actions taken by the federal banking regulators have primarily focused on subprime credit cards and have targeted practices such as:[8]

- "Downselling" consumers by prominently marketing one package of credit card terms, but then approving consumers only for accounts with less favorable terms;
- Issuing credit cards with low credit limits, then adding mandatory fees or "security deposits" resulting in little or no available credit when the consumer receives the card; and
- Deceptively marketing credit "protection" products.

Recommendation: The CPB recommends stronger criminal and civil penalties and a more coordinated effort between the State and the federal government with respect to complaint intake and enforcement.

6. Readability of Terms: The GAO reported that credit card disclosures are written at a level well above the reading level of an eighth-grader. About half of U.S. adults read at an eighth-grade level, leaving many consumers powerless to understand the terms and conditions of credit card agreements. In addition to the average reading level,[9] certain portions of the typical disclosure documents require even higher reading levels to be understandable. For example, the information about annual percentage rates, grace periods, balance computation, and payment allocation methods required a minimum of a fifteenth-grade education. Also, text describing the interest rates applicable to one issuer's card was written at a twenty-seventh-grade level. However, solicitation letters commonly required lower reading levels because these documents generally included more information in a tabular formation than cardmember agreements.

Recommendation: The CPB recommends that initial contract terms, as well as any change in terms, be written in a more readable format and in a manner that reflects the average reading level across the nation. In addition, credit card companies should provide a toll-free number dedicated to contract questions. We also recommend reformation of the Schumer box with input from consumers and advocacy groups. Redesigning the box should not be done without consideration of the type of information most beneficial to consumers and that such information be presented in a clear, uniform, and standard format.

Additionally, the CPB recommends strict regulations on lending to youth. Students are able to obtain credit without showing a history of credit usage, evidence of the ability to pay or proof of employment. Financial institutions have recognized that students will assume higher levels of debt at a

8 Id.

more accelerated pace if their consumptive behavior is obscured from their parents. Thus, for many of our youth, their debt capacities will be compromised at much earlier ages resulting in bankruptcy in their young adult years.

Furthermore, the Federal Reserve Board has recommended amendments to Regulation Z (Truth in Lending) intended to improve the disclosure notices connected to credit cards and other forms of revolving credit. These proposed amendments affect the five (5) primary types of open-end credit disclosures governed by Regulation Z:[9]

1. Applications and solicitations. Suggested changes to the format and content would make the credit and charge card applications and solicitations' disclosures more meaningful and easier for consumers to use.

2. Account-opening disclosures. The proposal would revise the cost disclosures provided at the opening of an account to make the information more conspicuous and easier to read.

3. Periodic statement disclosures. Recommended are revisions to make disclosures on periodic statements more understandable, primarily by making changes to the format requirements, for example by grouping fees, interest charges, and transactions together.

4. Changes in consumer's interest rate and other account terms. The proposal would expand the circumstances under which consumers receive written notice of changes in the amount of time these notices must be sent before the change becomes effective.

5. Advertising provisions. Also recommended are revisions to the rules governing advertising of open-end credit to help ensure consumers better understand the credit terms offered.

The proposed amendments to Regulation Z is an admirable first step. However, pure notification is not enough. Credit card issuer practices such as charging interest on debt that has been paid in full and late fees if a credit card issuer delays crediting a payment are just two egregious practices that should be prohibited. The proposed amendments should go beyond just notice, and

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9 Id. at 6 p. 38.

propose banning some of the practices currently employed to keep consumers drowning in debt.

IV. NYS Consumer Protection Board Initiatives

To address the abuses and strengthen consumer protections, the CPB is forming a Credit Card Practices Task Force to further examine issues and practices. The CPB will seek the partnership of various groups to advance State involvement in this issue since traditionally states have played major roles in advancing consumer protections and enforcement. This effort is aimed at federal preemption and the OCC's determination that nationally chartered financial institutions do not need to give deference to states' consumer protection laws.

The CPB has upgraded its consumer financial literacy and education program that will help New Yorkers make more educated financial decisions. Through this outreach opportunity, we are able to inform consumers on the benefits and pitfalls of credit card use. Additionally, we will be focusing our efforts on our youth and working with schools and community-based groups to communicate our message.

The CPB is expanding its website resources in this area, including access to a credit card debt calculator. This will help consumers calculate how much time and money it will take to pay off their debt. This tool will illustrate debt duration and the ultimate cost to the consumer. Another addition to our website is the posting of a model letter for consumers to send to regulators requesting an evaluation of credit card practices.

Finally, the CPB will be surveying consumers and industry participants regarding credit card practices. The results will be posted on our website to facilitate further analysis and discussion.

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10 Federal Register Notice: Section 1, Summary of major proposed changes.

V. Conclusion

The CPB acknowledges that credit cards enable consumers to purchase items and services during emergencies. Credit cards provide purchase protection and allow consumers to experience immediate gratification. Most importantly, credit cards provide convenience and a degree of safety. However, they also cause consumers to remain in debt and encourage people to live outside their means. Credit card issuers have resisted efforts to shine a brighter light on their practices and provide more meaningful and usable information to consumers.

Together, we can lead the effort to improve the marketplace providing consumers with more usable and helpful information and more meaningful protections.

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FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

SHEILA C. BAIR
CHAIRMAN

July 20, 2007

Honorable Melvin L. Watt
House of Representatives
Washington, D.C. 20515

Dear Congressman Watt:

This letter is in response to the question you asked at the hearing before the Subcommittee on Financial Institutions and Consumer Credit on "Improving Credit Card Consumer Protection: Recent Industry and Regulatory Initiatives" on June 7. I regret the delay in responding caused by the time necessary to fully research our response.

Enclosed is information I promised to provide in response to a question you posed during my testimony. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6974 or Eric Spitler, Director of Legislative Affairs, at (202) 898-3837.

Sincerely,

Sheila

Sheila C. Bair

Enclosure

Response to the
Honorable Melvin L. Watt

Below is the list of the 27 institutions the FDIC has identified as credit card lending specialists as of March 31, 2007. This list is derived from Call Report information and is therefore not confidential. An institution that exhibits both of the following characteristics is considered to be a specialized credit card lender: (1) credit card loans plus securitized and sold credit card loans divided by total loans plus securitized and sold credit card loans exceed 50 percent, and (2) total loans plus securitized and sold credit card loans divided by total assets plus securitized and sold credit card loans exceed 50 percent.

Credit Card Lending Specialists
March 31, 2007

Institution	City	State
1st Financial Bank USA	Dakota Dunes	SD
Discover Bank	Greenwood	DE
Wells Fargo Financial Bank	Sioux Falls	SD
American Express Centurion Bank	Salt Lake City	UT
USAA Savings Bank	Las Vegas	NV
Merrick Bank	South Jordan	UT
BB&T Bankcard Corp	Columbus	GA
Worlds Foremost Bank	Sidney	NE
Barclays Bank Delaware	Wilmington	DE
World Financial Capital Bank	Salt Lake City	UT
Capital One Bank	Glen Allen	VA
Citibank South Dakota N. A.	Sioux Falls	SD
Chase Bank USA National Assn	Newark	DE
Commerce Bank National Assn	Omaha	NE
Wells Fargo Financial NB	Las Vegas	NV
World Financial Network NB	Gahanna	OH
FIA Card Services NA	Wilmington	DE
Target National Bank	Sioux Falls	SD
Chevron Credit Bank Na	Murray	UT
TCM Bank National Assn	Tampa	FL
InfiBank National Assn	Atlanta	GA
CrediCard National Bank	Tucson	AZ
Town North Bank Nevada NA	Las Vegas	NV
Wachovia Card Services NA	Atlanta	GA
GE Money Bank	Salt Lake City	UT
Nordstrom Fsb	Scottsdale	AZ
FPC Financial Fsb	Madison	WI

Below is a list of financial institutions that provide credit cards to subprime borrowers. The Call Reports do not collect information from financial institutions with respect to subprime credit card lending. Thus, the list was derived from the respective institutions' websites and advertising materials, as well as from internet sites that provide listings of subprime credit card products. This list is not all-encompassing, but the institutions listed represent the majority of the subprime credit card market.

A number of other institutions not listed have subprime credit card product segments, but do not advertise subprime products, nor do they openly solicit subprime customers. Instead, they offer prospective customers a subprime card only after an applicant fails to qualify for a prime card. Information regarding these institutions is not readily available.

Institutions that Provide Credit Cards to Subprime Borrowers

#	Bank Name	City	State
1	Applied Card Bank	Wilmington	DE
2	Capital One Bank	Glen Allen	VA
3	Citibank South Dakota	Sioux Falls	SD
4	Columbus Bank and Trust Company	Columbus	GA
5	CorTrust Bank, National Association	Mitchell	SD
6	Credit One Bank, National Association	Las Vegas	NV
7	Dakota State Bank	Blunt	SD
8	Discover Bank	Greenwood	DE
9	FIA Card Services NA (Formerly MBNA)	Wilmington	DE
10	First Bank & Trust	Brookings	SD
11	First Bank of Delaware	Wilmington	DE
12	First Premier Bank	Sioux Falls	SD
13	HSBC Bank Nevada, National Association	Las Vegas	NV
14	Merrick Bank	South Jordan	UT
15	Monterey County Bank	Monterey	CA
16	New Millennium Bank	New Brunswick	NJ
17	Plains Commerce Bank	Hoven	SD
18	WebBank	Salt Lake City	UT
19	Wells Fargo Financial Bank	Sioux Falls	SD